

**JITI Air Cargo Transportation Seminar:
State of the Industry and Future Trends in Asia
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Remarks By

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Introduction

- Let me thank the Japan International Transport Institute for including me in today's seminar on air cargo. It is an honor to be invited to discuss this important subject. I am also delighted to share the podium with such a distinguished group of experts and practitioners.
- For many years, JITI has played a valuable role in promoting deeper, more nuanced understanding across the spectrum of transportation issues. From air services to high-speed rail, from security to the environment, JITI has brought us together to debate the critical transport questions of our time.
- The hard work and dedication of JITI's leaders and staff have contributed immeasurably to the success of these seminars. In some cases, seminal ideas broached here have played a substantial role in changing the direction of policy and, indeed, "changing the world."
- For example, at home I have a well-worn copy of the keynote speech that Professor Mike Levine delivered at a JITI conference here in Washington in January 2003.
 - In that speech, Professor Levine described a set of challenges facing aviation policymakers in Japan.
 - He noted—in polite but clear terms—that, because of the rules governing Tokyo's Narita and Haneda airports, Japan was, at that time, "the only major aviation nation whose airlines cannot integrate their international and domestic route systems."

- The Japanese transport ministry, MLIT, has now modified those airport rules, and more changes are likely in the future—changes aimed at removing this handicap on the development of Japan’s aviation market and providing to the people of Japan and the larger international community the benefits of an even more vibrant, more competitive, and more seamless transportation system.
- From conversations with Japanese colleagues, I know that Mike Levine’s speech played an important role in focusing attention on a fundamental problem and helping to build consensus for change.
- In my view, all of us are indebted to JITI for fostering this sort of careful analysis and open discussion among friends.

Overview

- This afternoon I would like to touch on four topics:
 - First, to set the stage, I’ll provide a quick update on recent developments in the air cargo market, especially in Asia. I’ll also say a few words about why air cargo matters so much.
 - Second, I’ll turn to the Japan-U.S. Open Skies agreement that was negotiated in 2009 and then signed in Tokyo last October. It’s an agreement that has attracted some interesting adjectives: unexpected, historic, miraculous. Having chaired the U.S. delegation in the negotiations, I’m quite biased, but I do like “miraculous.”
 - Third, I’ll take a look at the status of market access in the broader transpacific air cargo market, with a focus on U.S. carrier access.
 - Fourth, and last, I’ll pose a few questions that the aviation industry and government officials may need to address if air cargo is to reach its full potential for Japan and for the global economy.

Air Cargo: On the Rebound, Especially in Asia

- Let’s begin by asking: how is air cargo doing? According to the IATA air traffic survey for December, the year 2010 was one of “strong recovery,” with air freight “up by an exceptional 20.6%” worldwide. The freight load factor

rose 5.2 percentage points to a level of 53.8% globally; for Asia-Pacific airlines, the load factor was 65.9%.

- The importance of air freight in the Asia-Pacific region is hard to overstate. According to IATA, Asia-Pacific airlines accounted for some 45% of global freight-tonne-kilometers (FTKs) in December 2010.
- As for the future, IATA notes “some concerns over the strength of consumer demand” but concludes on the basis of underlying production data that a “phase of expansion for emerging economies will provide support for further growth in freight markets, although at closer to 5-6% historical levels.”
- At last week’s forecast conference in Washington, the Federal Aviation Administration (FAA) issued a projection that total air cargo revenue-ton-miles (RTMs) for freight, express delivery, and mail would increase from 35.9B in 2010 to 93.2B in 2031—up an average of 4.7% a year. FAA also forecast an increase in the cargo fleet from 806 aircraft in 2010 to 1,251 aircraft in 2031, an average increase of 2.1% a year.
- Looking at data from the Japan Air Freight Association, one sees an increase of well over 20% in the air cargo tonnage from Japan to the United States from December 2009 through November 2010, compared to the preceding twelve months. That level, however, is less than 70% of the tonnage carried in 2006 and 2007.
- Numbers are important, but sometimes a story is more compelling. I was very pleased by the recent news that Polar Air Cargo, after having withdrawn completely from the U.S.-Japan market several years ago, now plans to resume service next month, operating as many as six weekly transpacific frequencies to Narita, with service beyond to Seoul and Shanghai.
 - Polar’s decision reflects, of course, the rebound in the world economy and the overall level of export activity.
 - Polar’s decision to reenter the Japan market, however, is also linked to the new rights and operational freedoms that Polar—like every American and Japanese air carrier—enjoys under our bilateral Open Skies agreement. More on that in a moment.
- But first, just a few words about the importance of air cargo, an importance that is magnified for highly developed, sophisticated economies like those of Japan and the United States.
- It’s rare that one uses air cargo to transport scrap metal, concrete culverts, or the mass-produced cheap plastic toys that line the shelves at Walmart and Target.

- As we all know, air cargo makes sense—indeed, air cargo is essential in today’s economy—for valuable commodities where suppliers and customers need speed and the certainty of on-time delivery.
- It is precisely those products and those supply chains that are so important to the Japanese and American economies.
- While I was at the State Department, two of the most fascinating trips I ever took were not overseas. Instead, they were to Louisville and Memphis to witness the night-time hub operations of UPS and FedEx. Shortly before midnight, the sky lights up as scores of airplanes land, one after another. Cargo is unloaded, processed in a matter of hours in state-of-the-art facilities, and then placed on outbound flights for delivery to customers, often only a few hours later.
 - Japan invented the practice of “just in time” delivery. In Louisville and Memphis, “just in time” delivery becomes reality, on a global scale. I’d strongly urge any of you who are offered a chance to visit one of these facilities to do so. It’s fascinating, it’s fun, but it’s also deeply instructive of how modern commerce is inextricably linked to air cargo.

The U.S.-Japan Open Skies Agreement

- On October 25, 2010, the Japanese transport minister and the American ambassador to Tokyo signed the Open Skies agreement that had been negotiated ten months earlier.
- For the most part, the press focused on the passenger side of the equation: for example, the expanded opportunities for both sides’ airlines at Haneda airport and the grant by DOT of antitrust immunity to the joint ventures proposed by United, Continental, and ANA and by American and JAL.
- The importance of the Open Skies agreement for air cargo, however, is equally compelling. Under the maze of complex agreements, side letters, and understandings that governed Japan-U.S. aviation relations prior to last October, airlines were strictly regulated by the equivalent of a caste system of rights.
 - For airlines with so-called “incumbent” all-cargo status, the frequency of flights was not limited and the right to operate air service beyond the territory of the other Party was not significantly restricted.
 - However, for non-incumbent all-cargo airlines—a group that included, for the United States, UPS, Polar, and Evergreen—the U.S.-Japan market was a straightjacket of limitations.

- UPS, for example, was limited to eighteen frequencies per week—with not more than six of those to Tokyo. Destinations beyond Japan were limited to two points from each of a maximum of three Japanese cities.
- Polar was more restricted, with only twelve frequencies, to a maximum of two Japanese cities, with only six frequencies allowed at Tokyo, with only one point allowed beyond Tokyo (and it could not be Beijing), and with only two points beyond the second Japanese city. And, by the way, not more than six frequencies were allowed to Shanghai.
- Of the three U.S. non-incumbent all-cargo airlines, Evergreen drew the shortest straw under the old system: it could operate not more than five weekly frequencies, could not serve either Tokyo or Osaka, had no fifth-freedom “beyond” rights, and had to fly to and from a city in the United States other than Anchorage, Los Angeles, San Francisco, Chicago, New York, and Atlanta.
- As for any other U.S. all-cargo airline that wanted to enter the Japan market, the door was shut.
- Explaining how Japan and the United States managed to negotiate an Open Skies agreement would take us far longer than the time I’ve been allotted. Results, however, are what matter, and the negotiations delivered exceptional results.
- The new agreement exiled to the musty archives of aeropolitical history the discriminatory, anti-consumer, anti-competitive, anti-growth restrictions that had characterized the old legal regime and substituted instead a much simpler bilateral air transport agreement that contains all the elements of Open Skies. This means no limits:
 - on the number of airlines permitted to fly;
 - on the number of flights operated;
 - on the types of aircraft used;
 - on the Japanese and American cities served;
 - on the number or identity of points served in third countries; or
 - on the ability of airlines to price services on the basis of market demand.
- There are three aspects of the Open Skies agreement that I want to flag for reference in the final portion of my remarks.
 - First, Japan did not endorse the U.S. proposal to include so-called “seventh freedom cargo rights” in the new agreement. Such rights permit airlines to operate all-cargo services between the territory of the partner country and third countries without the requirement for connecting service to or from the

airline's homeland. Seventh-freedom cargo rights are not an essential element of Open Skies, but the United States favors their inclusion.

- Second, with respect to flights between Haneda airport and the United States, the two governments stipulated that, until otherwise agreed, slots at Haneda shall not be used for all-cargo services.
- Third, although the Record of Discussions that accompanies the Open Skies agreement records certain understandings on the allocation of new slots at Narita, there is no guarantee—just as there is no guarantee in any Open Skies agreement—that carriers of either side will automatically receive all the slots they seek or slots at times that they consider most advantageous.

Air Cargo Access in the Broader Asian Market

- Let's turn briefly to the broader Asian market. For the United States, the signing of the Japan agreement last October came after over a decade of efforts in Asia promoting the idea of Open Skies.
- Today, America's aviation relations with most of the countries in Asia are governed by Open Skies accords.
 - Several Asian countries—Singapore, New Zealand, Brunei, Samoa, Tonga, the Cook Islands, and, for cargo only, Mongolia—are parties to the 2001 Multilateral Agreement on the Liberalization of International Air Transportation, the so-called MALIAT or Kona accord.
 - Other Asian Open Skies partners on a bilateral basis include major economies such as Australia, Indonesia, Korea, Malaysia, Taiwan, and Thailand.
- Yet there's still work to be done by U.S. negotiators: for example, in Vietnam, in Hong Kong, and particularly in mainland China, whose importance for air cargo is simply enormous.
 - According to legend, when a reporter asked the famous American gangster, Willie Sutton, why he robbed banks, he answered, "that's where the money is."
 - Pose a similar question to an all-cargo airline, "Why do you fly to China?", and the answer will be, "That's where the freight is."
- The United States and other countries still have much work to do to convince the authorities in Beijing that it is in their interest—for their airports, their airlines, and their national economy—to liberalize fully China's air transport relations with other countries. And—a point that is equally important—to introduce greater consistency and transparency to issues such as slot allocation.

- Other speakers today are in a better position to discuss the important, recent efforts of Japan to expand opportunities for air transportation within Asia. In my view, this forward-looking approach of MLIT is to be commended and supported. Japan's aviation policy, today, appears to be on a path intended to facilitate commerce, promote exports, and provide the infrastructure essential for today's global economy.
- The modern world may be flat and e-commerce may be ubiquitous, but to move goods from Point A to Point B—whether within Asia, across the Pacific, or anywhere on the globe—one still needs transportation. Good policy will seek to remove barriers to the most efficient air transport possible and, in addition, will foster cooperation with the private sector—with airlines and airport managements, in particular—to create an environment that encourages flying and fosters entrepreneurship, innovation, and a keen focus on customers.

Some Questions for the Future

- Let me conclude my remarks by posing a few questions that may be of interest to the cargo industry and government policymakers.
- The first question: does Japan want its airports to be cargo hubs? I suspect that the answer is “Of course, why not?”
 - There are some, however, who have suggested that Japan missed its chance through the restrictive policies it implemented in the past and that, just as both UPS and Fedex have now moved hubs from the Philippines to China, the world of air cargo has now largely decided to “fly over” Japan.
 - I'm not so sure. Japan's advantageous geographical position on the edge of the transpacific market, its still enormous economy and wealth, its sophisticated productive capacity, and its government's endorsement of an “Asian Gateway” aviation policy in the last few years suggest to me that not all is lost.
 - Indeed, I understand that we may hear about some important developments from our colleague from ANA, Mr. Toshiaki Toyama.
- Creating, sustaining, and expanding hubs, however, entails challenges.
- One of those challenges for Tokyo airports is securing predictable access to slots. The reason is simple: without confidence that there is not only the right to fly to an airport but also a reasonable opportunity to obtain commercially viable slots there, an air cargo business will have serious reservations about selecting that airport for hub activities.
- This leads me to a second question: will the Japanese Government move from its current tightly controlled policy—its “local rule”—on slot allocation to

either full implementation of the guidelines published by IATA or, indeed, to secondary slot trading or a slot “buy/sell” regime?

- A third, related question is how will Japan balance the sometimes competing goals of, on the one hand, supporting Japanese air carriers and, on the other hand, fostering the broader Japanese export economy by maximizing competitive and efficient air cargo service?
- A fourth, corollary question is whether Japan will, at some point, be prepared to revisit the issue of seventh-freedom cargo rights.
- A fifth and final question—one that requires analysis and decision by the American as well as the Japanese side—involves Haneda Airport. Specifically, when and under what conditions might Japan and the United States lift the ban on the use of Haneda for all-cargo air service?
 - This is a complex issue that requires a look at how quickly international air service will expand at Haneda, at whether a fifth runway will be build in Tokyo Bay, at whether space for appropriate warehousing and other on-the-ground cargo facilities can be made available, and, as always, at how to ensure a fair and equal opportunity for all interested airlines to offer service.

Conclusion

- It’s a bit odd to make a keynote presentation that, instead of answers and solutions, concludes with a set of questions and challenges.
- The vibrant, fast-changing world of air cargo, however, requires us to focus on the future, pose tough questions, and foster debate.
- Looking back on over three decades at the State Department, I can say that the signing of our bilateral Open Skies agreement was one of the most satisfying, professionally and personally most rewarding moments in my career.
- Nevertheless, the challenge of structuring aviation relations to meet the demands of an ever-changing marketplace will always be a work in progress, one that requires focus, dedication, hard work, and the cooperation of governments and private sector stakeholders.
- In closing, I again wish to thank the Japan International Transport Institute and also everyone in the audience for the opportunity to speak today. We have a fascinating topic before us, and I look forward to the presentations by my colleagues.
- Thank you.