



IMPACT OF THE NEW U.S. AVIATION POLICY ON EAST ASIA, WITH SPECIAL REFERENCE TO THE NEW U.S.

CHINA NEW BILATERAL AIR SERVICE AGREEMENT

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1 INTRODUCTION



Traditionally East Asian countries and regions such as China, Korea, Japan, Hong Kong and Macao and Taiwan have adopted a regulated aviation policies vis-à-vis third countries, particularly the United States. Nevertheless, East Asia has constantly faced a challenge from the United States stemming from the USA Airlines Deregulation Act of 1978 and the International Air Transportation Competition Act of 1979, which gave U.S. airlines a widely autonomous executive power to compete with other airlines within and outside the United States.

During the Uruguay Round Negotiations just before the signing of the Marrakesh Agreement establishing the World Trade Organization (WTO) in 1995, deregulation and liberalization of trade in goods and services reinforced adoption of the new U.S. new internationally liberalized air transport policy as reflected in a series of bilateral air service agreements between the U.S. and European and Asian countries. The resistance of Asia countries, particularly of East Asian countries, to opening the aviation market to U.S. carriers eroded under tremendous globalization pressure exerted by industrialized countries within the framework of the WTO and other

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regional economic integration arrangements.

Inevitably, export-oriented East Asian countries and regions had to compromise with the demand of the United States to open Asian aviation markets, as reflected in existing bilateral air service agreements. The U.S.-Korea Air Transport Agreement of June 9, 1998, the U.S.-China Initial Aviation Liberalization Agreement of May 2007, and the U.S.-Hong Kong Air Service Pact of 2008 and the proposed new U.S.-Japan Air Service Agreement created a new regime that sharply expands US carriers' access to various international airports in the said Asian countries and regions. Besides, a new U.S.-EU air service agreement signed in 2007 is expected to pave the way to overall liberalization of U.S. and European aviation markets and exert considerable influence on East Asian aviation markets as well.

This paper intends to analyze the salient features of the new air service agreements concluded between the U.S. and East Asian countries and regions and their impact on East Asian air transportation as a whole and on hub airport management and operation in particular.

II U.S. AIR TRANSPORT POLICY TOWARD EAST ASIA



Air transport in the East Asia region is growing faster than anywhere else, but the airline industry operates in a tightly regulated regime. Moreover some airlines in East Asian countries and regions operating in fragmented and inefficient single hub networks and air transport system have not been organized to cope with the intensifying intra-regional trade and economic integration taking place in the region. Furthermore, no pan-Asian and multi-hub airlines exist among East Asian countries. In facing such a situation, the United States has gained considerable advantage in its competition with Asian airlines and their home hub-airport. It is now the aim of the United States to negotiate with East Asian aviation authorities to conclude a new phase of air transport agreement liberalizing business arrangements within the framework of APEC and WTO in the name of globalization movement.¹⁾ That is to say, the United States intends to expand its claims to the air transport sector as a part of package deals with Asian countries and regions.

The U.S. carriers shifted to a multi-hub system following deregulation and are eagerly looking at overseas markets with special attention to East Asian and the

1) See Findlay, C., *The APEC Air Transport Schedule*, Pacific Economic Paper, No. 273, November 1997, Australia-Japan Research Center, pp. 1-20.

Southeast Asian region as a whole. The long term aviation policy of the U.S. is to expand its traffic volume around the Chinese market. Two strategic techniques are to be used: to increase the unlimited and unconditional frequency of third and fourth freedom of air traffic rights; to gain for the moment more fifth freedom traffic rights, and rights beyond, from Japan, Korea, Hong Kong and Taiwan; to establish or strengthen for the moment single East Asian hubs at Incheon and Narita, and at Hong Kong and Taipei at a later stage, if possible.

The U.S. mega carriers and their alliances, the emergence of a new generation of low-cost airlines, and the growth of a tourist industry all have exerted various degrees of pressures on Asian air transport regulatory system. One important factors forcing Asian countries to yield the demands from the U.S. and the European Union (EU) is that air transport, as with other matters related to trade, has been frequently used by industrialized countries as a weapon to force developing countries to open their gates to profitable trade in services. The U.S. aviation policy makers would like to see using that weapon to negotiate a new phased air service agreement in order to share Asian airlines profits under a more liberalized air transport regime. The successful conclusion of a new type of liberalized air transport regime between the U.S. and the 27 members of EU would have a tremendous impact on the Asian air transport industry too.

In fact, the U.S. has successfully gained an advantageous position in Korea and Japan and Taiwan. China and Hong Kong have avoided in one way or another, providing U.S. carriers with enough fifth freedom traffic rights for them to meet their goals, but recent new air service agreements have indicated a new phase in China and Hong Kong vis-à-vis the U.S. demand.

III LIBERALIZATION OF THE U.S - CHINA AIR SERVICE AGREEMENT IN 2007

China, like other East Asian countries, has always shaped its air transport policy with restrictive bilateral air service agreement reached with foreign aviation powers. The first China-U.S. civil air transport agreement was signed on September 17, 1980 and a protocol to amend the Agreement was signed on July 9, 2007. China's strictly regulated air policy was relaxed gradually after it joined the WTO in 2000. The former treaty was a regulated regime, while the latter protocol was a partial open skies agreement paving the way to negotiate of full liberalization of the bilateral air transport market based on a phase procedure.

The landmark air service agreement between China and U.S. will permit a nearly

five-fold increase in air services over the next six years. It will also eliminate restrictions on destinations, permit unlimited code-sharing between airlines on both sides and allow service to several more cities in both countries.²⁾

The salient features of this new phased open skies agreement may be summarized as following:

1. The 2007 new phased agreement adds 10 new daily passenger flights that U.S. carriers may operate to the Chinese gateway cities of Beijing, Shanghai and Guangzhou over 2008-2012, doubling the number of such flights they may now operate;³⁾ In other words, the agreement will allow a total of 195 new weekly flights for each country, 111 by all-cargo carriers and 84 by passenger airlines, growing to a total of 249 weekly flights by 2010. A total of 14 of these flights became available for new US passenger services on August 1st, 2004. As of March 25, 2011, the United States may designate an unlimited number of airlines to operate the agreed services on U.S. Route B.⁴⁾ China meanwhile may designate an unlimited number of airlines to operate the agreed services on China Routes A and B. beginning as of August 1, 2007.⁵⁾
2. An unlimited U.S. cargo flight to any point in China is allowed. An unlimited number of U.S. cargo carriers may serve the market as of 2011;
3. The number of U.S. passenger carriers that may serve the Chinese market is increased from six to nine by 2011;⁶⁾
4. Opportunities for U.S. carriers to code-share with other U.S. carriers on flight flights to China are expanded;⁷⁾ and
5. The U.S. and China are committed to launch Open Skies negotiations in 2010.⁸⁾

However, the new China-US air service agreement would not remove a hurdle in way of total liberalization, namely the 1995 PRC Civil Aviation Law still follows the classic national civil aviation legal regime. That regime is unable to accommodate

2) Existing rules allow US carriers to fly to five Chinese cities only, and Chinese carriers are restricted to twelve US destinations.

3) Article 2, Frequencies,, Protocol Amend the Agreement Between China and the U.S., loc. cit.

4) Article 1, Designation, (h), Protocol Amend the Agreement Between China and the U.S., *ibid.*

5) Article 1, (d), *ibid.*

6) Article 1, *ibid.*

7) Article 4, *ibid.*

8) Article 5, Protocol to Amend the Agreement Between the Government of the United States of America and the Government of the People's Republic of China relating to Civil Air Transport, at <http://www.state.gov/documents/organization/88275.pdf>. (2008/5/15)

needs arising from the modern concept of an open skies policy within the framework of globalization.⁹⁾ The specific obstacles are these:

First, the nationality clause of PRC Aviation Laws and Regulations asks that foreign designated air carrier be substantially owned and effectively controlled by the designating State or its nations.

Secondly, the principle of limitations on foreign ownership and control requires that airlines must have Chinese ownership and control.

Thirdly, the existing PRC laws do not provide a right of establishment for foreign investors or establish themselves in China.

Fourthly, cabotage is still reserved exclusively for national airlines.

As well, there are other restrictions on seventh freedom rights, wet leasing, performance requirements, limits on frequency, etc. These will take some time to be eased in the future.

IV IMPACT OF THE NEW U.S.- CHINA AIR SERVICE AGREEMENTS ON EAST ASIA

In the long run, the new U.S.-China air service agreement will inevitably exert

considerable influence in several directions over East Asian aviation industry. First of all, the division of scheduled and non-scheduled air traffic will be blurred in terms of open skies agreements. Scheduled and non-scheduled air traffic rights are essentially implemented by third and fourth traffic right, which are regulated under a doctrine that basically requires a 50/50 exchange of values. The traffic restriction on third and fourth freedom will play a lesser role than the requirement of the old Bermuda capacity clauses of bilateral air agreements. After all, the backbone of air carrier traffic rests on the third and fourth freedoms, but the new China-US agreement and the recent EU-US Trans-Atlantic Single Aviation Market have changed its original feature. Furthermore, the removal of restrictions imposed on third and fourth freedom traffic rights would have a profound impact on fifth and sixth freedom traffic rights as well as the operation of home based hub airports.

The fifth freedom concerns the right to take on passengers, mail and cargo destined for the territory of another other State, and the right to put down passengers, mail and cargo coming from any such territory. For a U.S. carrier, a fifth freedom to fly would provide extra profit from a long haul flight across the Pacific Ocean if

9) Cheng, C.J., "Internationalization of Civil Aviation Law in China", in Schnitker and van's Gravesande, J.W.S. *Journal Lucht Recht - Liber Aamicorum in Honour of Prof. Dr. I.H.Ph. Diederiks-Vrschoor*, Special edition, Nr. 9/10, The Hauge, December 2003, pp. 71-82.

the US carriers is allowed to pick up passengers or cargo en route –, for example, in Hong Kong, Narita and Incheon airports – and then fly on to a third country instead of returning directly home. The removal of fifth freedom traffic restrictions will ensure that a hub airport may become one of the most important logistics centers in Asia.

Liberalized air transport between China and the U.S. in the future will also provide opportunities for East Asian carriers to fly under the sixth freedom in order to accelerate the flow of goods and passengers into and out of their home hub airports while providing substantial benefits to businesses, workers and consumers.

Nearly all Asian countries have operated fragmented and inefficient single hub networks with East Asian hub airports unable to feed long haul cabin. For example, Incheon's hub has to collect passengers and cargo from nearby airports of other countries and regions. Thus, the third and fourth traffic rights could play a vital role in bring in foreign passengers and cargo to Incheon and then allowing them to fly to other destinations via other flights of the same airlines or other national airlines. In this case, the sixth freedom of traffic comes into play between it also allows connecting flights between the home State airport and the foreign airports.¹⁰⁾ The first priority in regulatory reform of traffic rights is to remove any percentage restrictions in the carrying of fifth and sixth freedom passengers.

Finally, a few words on the impact of the “EU designated airline clause” on Asian airlines may be in order. Under this clause, any EU member country can designate an airline of any other of the 27 EU member as its national EU flag carrier. The viewpoints of Korean Air and Asiana, pro and con are extremely conflicting on this matter. In the long run, it seems that we may unable to influence EU exclusive rulings in international air transport according to judgments of the European Court of Justice.¹¹⁾

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- 10) Wassenbergh, H., “The Sixth Freedom Revisited”, *Air and Space Law Journal*, Vol. XXI, No.6, December 1996, pp. 285-294; See also, Cheng, C.J., *Regulatory Reform in International Air Transport: Henri A. Wassenbergh's Select Essays Over A Period of Fifty Years 1950-2000*, Regency Publishing Worldwide, San Francisco and Los Angeles/Asian Institute of International Air and Space Law, Taipei, 2000, pp.925941
- 11) See ECJ decision on 5th November 2002 at Cases C-466/98, C467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98, C-476/98 against the United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, and Germany, cited by Jiangtian Xu, *Open Sskies Agreement between China and European Union*, at <http://www.euroculturemaster.org/pdf/xu.pdf>, , p. 6. (2008/515).

V CONCLUSION.



Under the globalization wave and the WTO management, international air transport as a type of international trade has won acceptance among most developed countries, particularly the United States. The East Asia region is one of the most lucrative air transport regions, and with the rising economic power of China accompanied by expanding aviation opportunities between the US and China, it is natural for U.S. policy negotiators to wish to open the Asian regulated aviation market. The recent new China-US air service agreement reflected the desire of the US to negotiate a total open skies agreement with all East Asian states. In fact, Korea has already signed and Japan is going to renegotiate a new open-skies agreement with U.S. in the foreseeable future.

The direct impact of the U.S. type of open skies agreement on East Asian countries will change traffic rights operation patterns, particularly with regard to the third, fourth, fifth and sixth freedoms. These traffic rights will reinforce the competitiveness of hub airports. Current hub systems offer limited growth opportunities to Asian airlines and would not contribute to the development of efficient multiple hub networks in East Asia. Currently no airline in East Asia is truly an Asian carrier having an effective coverage of Asian markets.

East Asian countries are not only facing challenges from the United States but also from the European Union. Adoption of the new type of open skies agreement between the US and European Union would surely impact the East Asian air transport industry.

All things considered, East Asian countries have to reconsider how to reform their existing air transport systems as well as their management and operation of hub airports. The new China-U.S. air agreement constitutes a warning to other East Asia countries that the U.S. would negotiate with China “an agreement and timetable for the full liberalization of their bilateral air transport market and to work together to complete the new agreement as soon as possible that will affect deeply Korea and Japan aviation industry”.¹²⁾

12) See Article 5, Future Negotiations, Protocol to Amend the Agreement between U.S. and China relating to Civil Air Transport, at <http://www.state.gov/documents/organization/88275.pdf>. p. 5.