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Beyond the Chicago Regime: The Chicago Regime Research Committee Report by the Japan International Transport Institute

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I. Preface

In the world of international air transport, liberalization is the world trend. The United State has concluded 91 open skies agreements[1]. The European Union, after the famous judgment of the European Court of Justice on 5 November 2002, has corrected 112 bilateral air agreements with 54 States and has concluded 33 horizontal agreements which has represented 525 bilateral agreements[2]. These new agreements are basically open skies ones.

However, the Chicago Convention on International Civil Aviation still remains to be the backbone of international air transport. Article 1 of the Chicago Convention provides that every State has complete and exclusive sovereignty above its territory and it does not provide the economic privileges related to free airspace. Since the Chicago Convention was signed in 1944, the economic environment concerning international air transport has greatly changed. Should this old-fashioned Convention be amended or updated ?[3] The Japan International Transport Institute, a part of the Institution for Transport Policy Studies (Unyu Seisaku Kenkyu Kiko), a leading Japanese think-tank in the field of transport, studied this problem and submitted Chicago Regime Research Committee Report in December 2006[4]. I joined the Committee as a member. In this Article, after citing the summary of the Report, I would like to pick up some of the topics for further analysis.

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1) http://www.state.gov/e/eeb/rls/othr/2008/22281.htm

2) http://ec.europa.eu/transport/air_portal/international/pillars/horizontal_agreements_en.htm

3) On the evaluation and the amendments of the Chicago Convention, *see* Michael Milde, Chicago Convention at Sixty – Stagnation or Renaissance ?, *Annals of Air and Space Law*, vol. XXIX (2001), pp. 443-471

4) The report is available at http://www.japantransport.com/publications.html
The Committee was chaired by Mr. Jiro Hanyu.

II. Summary of the Chicago Regime Research Committee Report

This Report consists of five chapters.

Chapter 1 looks back the history of the Chicago Regime and its effects. Since the Chicago Convention was concluded in 1944, international aviation has developed to a remarkable degree and has become more important in the international community. However, the Chicago Regime has remained unchanged.

Chapter 2 details problems with the Chicago Regime. International aviation continues to operate under concepts that are outdated and incompatible with the free and diversified modern economic systems which are applied to other economic fields. Everyone recognizes that these agreements are outdated at odds in modern international economics. Efforts to improve, correct, modify or remove the restrictive agreements of the Chicago Regime, such as the open skies agreements and regional liberalization, have been inadequate.

Chapter 3 takes the first steps toward improvement, offering the direction for reforms and the process of liberalization. Because of recent international situations, governmental restrictions on international aviation are alleged to be necessary for national security. These restrictions should not adversely affect ordinary economic dealings which has no relation with national security. We should move toward a new international aviation order as a liberalized and competitive market in which market functions operate properly.

Chapter 4 offers various proposals for improvement. Based on the discussions at ICAO, the complexity of negotiations on bilateral aviation agreements, protectionism and post 9.11 security enhancements, it seems that it will be hard to make progress solely by the fact that a proposed reform seems to be desirable. Realistic compromise is required.

Chapter 5 presents measures for Japan for handling all of the issues. These include liberalization negotiations with US and EU, consolidation of the air industries in East Asia and a general approach of rapid liberalization.

This Report proposes significant changes to the Chicago Regime. It is the purpose of this Report to serve as a stimulus for international discussion toward improving the international aviation system.

The details of each Chapter are as follows.

Chapter 1 : History of the Chicago Regime

The intent of the USA in taking the initiative in establishing the Chicago Convention was to create a free system for international aviation business. However, the Chicago Convention recognized airspace sovereignty and denied the right of innocent passage and did not secure the necessary "freedoms of the air," requiring many bilateral agreements. The principle of exclusive sovereignty of airspace does not logically require a system of prior permission.

Chapter 2 : Problems with the Chicago Regime

(1) Changes in the circumstances of aviation

As the aviation industry was in its infancy, it was considered to require protection from overseas competition. The bilateral agreements resulted in a fragmentation of the global aviation market, with many different sets of restrictive rules in force.

The last half-century has seen international air services become mass-consumption industry, one whose business methods have changed significantly in recent decades to exceed the confines of nationality. In the 1990s, aviation businesses began competing to acquire customers beyond their borders, forming global networks through business alliances. As a result, airline Q in State B in an alliance with airline P in State A may have interests that conflict with those of airline Y in State B in an alliance with airline X in State A. Such conflicts of interest between airlines can be a more important factor than the conflicts of interests between States. We should therefore reexamine whether or not strict regulations currently enforced in the international aviation

industry, like advance permission, capital restrictions and nationality requirements, are truly necessary for national security.

(2) Systemic problems and their negative effects

① Segmentation of international aviation operations

A problem with the Chicago Regime is the segmentation of international aviation service, with separate regulations for each area. In order to achieve their goal of providing air transport corresponding to the market demands, airlines seek to build networks to optimally meet these demands. Therefore, there should also be a regulatory framework for international aviation designed to help optimize the networking of aviation services for the market. Specifically, the freedom of the air is granted to aviation businesses in the form of privileges in operating international aviation operations under bilateral agreements or other frameworks. Due to this segmentation of the international aviation operations, airlines can provide only limited service under bilateral agreements. They cannot satisfy the demands.

A further problem is that the Chicago Convention makes no distinction between scheduled and non-scheduled flights. In stark contrast to the 1940s when the percentage of non-scheduled flights in international aviation was extremely low, non-scheduled flights (charter flights) now account for a huge volume of traffic. Unclear and excessive intervention by governments in non-scheduled flights hampers the efficient operation of the international aviation market.

② Determination of aviation service details by governments

Article 6 of the Chicago Convention provides that no scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization. Therefore, bilateral agreements provide for such special permissions to enable operations. This means that the details are subject to a process of permissions and approvals by the government of each State. Market competition has been

encouraged in other modes of transportation and deregulation has been underway to reduce regulation to a minimum level. Nevertheless, international aviation remains subject to government intervention in the form of numerous economic restrictions.

(i) Market access: Governments designate which airlines will be permitted to participate in the market and determine the routes and frequencies. An airline in an alliance is subject to the restrictions of the State of their alliance partner, their own State and any other third States. Since the demand for international air transport is sufficiently strong, it is possible for participating airlines to use economies of scale and offer the appropriate capacity. It is clear that competition in the international aviation markets is working, and that it is meaningless to continue government regulation to protect specific airlines.

(ii) Capacity controls: Many bilateral agreements provides the capacity clause which includes the followings: (a) the service shall bear a close relationship to the requirement of the public, (b) there shall be fair and equal opportunity for the designated airlines to operate the agreed services, (c) the interests of the designated airlines of the other Contracting State shall be taken into consideration so as not to affect unduly the services which the latter provide and (d) the primary objective must be to provide at a reasonable load factor capacity adequate to current and reasonably anticipated requirements for the carriage of passengers, cargo and mail originating from or destined for the territory of the Contracting State which has designated the airline. As a result of these capacity controls, monopolistic advantage in the market between the two States is ensured. This system reduces incentive to operate efficiently through competition and results in a loss of the potential for consumer surplus.

(iii) Fare controls : For international aviation, there is a system of agreement on fares between designated airlines under bilateral agreements and the IATA fare determination mechanism. This fare system avoids competition through divisions and monopolies of the markets in two States, and results in expensive fares because the airlines have no incentive to provide competitive fares.

③ Cabotage

Article 7 of the Chicago Convention provides that Each contracting State

shall have the right to refuse permission to the aircraft of other contracting States to take on

in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory. Most States sustains such prohibitions. Argument based on national security is not convincing for supporting such prohibitions, because domestic flights pose no greater inherent risks to the national security than international flights. It can be concluded that the real reason for such prohibitions is nothing but to protect domestic airlines. Cabotage can obstruct the realization of fair competition in the international aviation market.

④ Restrictions on Capital and Labor

(i) Nationality Requirements : Most bilateral air agreements include a nationality clause and it provides that each contracting State reserve the right to withhold or revoke the privileges in respect of an airline designated by other Contracting State in any case where it is not satisfied that substantial ownership and effective control of such airlines are vested in the Contracting State designating the airline or in nationals of such Contracting State. Concerns over foreign company having undue levels of influence on a company's own domestic aviation business are legitimate. From the point of clarifying the responsibility for safety and security, nationality of aircraft has an important role, but a sufficient level of safety and security can best be satisfied not by the nationality clause but by ensuring an international safety standard regardless of nationality.

(ii) Wet Lease Restrictions: In many States wet leases are limited to domestic aviation businesses. The restrictions on wet leases are another manifestation of nationality requirements, as well as a labor union issue, as the lifting of the ban on wet leases is opposed by unions on the grounds that this will take jobs from the domestic flight crews. On the other hand, there are also concerns about safety issues with regard to wet leases. But there is no reason to exclude foreign companies. It would be sufficient to deal with these problems by establishing regulation and exclude companies with substandard safety records, whether domestic or foreign.

(3) Assessment of recent efforts toward liberalization

① The US Open Skies

Many of the problems with the Chicago Regime have successfully been solved within the framework of the Open Skies Agreement in the United States, which mitigates some of the government restrictions related to market access, and determination of transport capacities and fares. However, as a liberalization mechanism the Open Skies policy is only a partial solution and incomplete inasmuch as it recognizes reservation of cabotage for domestic businesses, and is overwhelmingly advantageous to profit-earning US aviation businesses that have access to a huge domestic market. Secondly, nationality clause and wet lease restrictions remain as strict as ever. In the US, only a 25% foreign ownership share is permitted, and wet leases are limited to those from American aviation businesses. Since free international movement of capital and labor is not recognized, the functioning of the international aviation market is incomplete in the US.

② Liberalization policies within the EU

The EU implemented three liberalization packages and it can be considered more far-reaching than the US Open Skies Policy. The results of the complete implementation of the final stage in 1997, the were complete liberalization of all The "freedom of the air" was attained by the 3rd package and the elimination of government interference in route designation and the capacity controls within the European Community were abolished. However, the relationships between member States and third States are still governed by the restrictive framework of the Chicago Regime. In other words, the EU liberalization is not open to States outside the region. It remains to be seen whether the EU liberalization will be actively expanded to States outside the region, which, if it does, will be an effective means of reforming the Chicago Regime.

Chapter 3 Reform Directions

(1) Basic concepts

Protection of domestic airlines as well as intervention into the international aviation markets by governments has given serious effects to the sound developments of aviation industries. It is possible to achieve efficient air services simply by maintaining the market functions that enable competition. Accordingly, the first concept for a new international aviation order is that the international aviation market should be a competitive market where market functions operate properly. The new international aviation system should be uniform.

(2) Relationship between sovereignty of territorial air and liberalization

From the perspective of national security, a system in which governments may exercise sovereign rights over territorial air in order to apply restrictions on foreign aircraft is appropriate. However, this exercise does not automatically justify restrictions on capacity, routes and fares of foreign airlines. Restrictions based on territorial sovereignty will not be applied to ordinary economic activities by foreign airlines as they do not affect national security.

(3) Details of new rules

The new international civil aviation system should aim to form consistent and worldwide rules for the purpose of (a) forming properly functioning, competitive aviation markets and (b) restricting the exercise of territorial sovereignty to impede the economic activities of international civil aviation at times of peace. Economic restrictions will be eliminated, and international air transport business will be subject to the new rules. It is also necessary to abolish government subsidies and assistance, which are a major disruption to

the proper operation of market functions.

(4) Effects of liberalization

The liberalization will bring significant fare declines and increase in flight frequency. Airlines can increase their own profits and the elimination of regulations will bring numerous benefits to air travelers.

(5) Other issues for discussion

(a) Access to infrastructure

The largest issue at crowded airports is the allocation of slots, which are granted on a first-come first-served basis; even if an airline has the right to conduct air transport, this right cannot be exercised if it cannot obtain slots at the airports. In order to create competitive markets, it is necessary to change the slot allocation rules that currently grant too much consideration to vested interests. Two methods are proposed. The first method is to establish a free competition framework by use of a lottery for a portion of the available slots, in addition to the current system of priority for new participants. The second method is to expand the definition of a new participant. An airline that has fewer than a fixed number of slots per day for an international route is considered a new participant and be given priority in the next slot allocation.

(b) Application of competition law : See 3.

(c) Consumer protection

If liberalization of international aviation is implemented on a worldwide scale, it might result in oligopolies. Some of the negative effects of oligopolies may be prevented by slot allocation rules and by protecting consumers from excessively high prices. It will also be necessary to order airlines to disclose information in order to ensure fair transactions. Uniform international rules on consumer protection are required and they should include rules concerning discount tickets, compensation for delays, cancellations and lost luggage.

(d) Dispute settlement mechanism : See 3

(e) Abolition of government subsidies

Government subsidies to aviation businesses hinder effective functioning of the market. This treatment must be prohibited under the new regime. Exceptionally, some subsidies are required to help maintain local air links as part of social policy. It is necessary to establish a system to fully oversee and check whether government subsidies are distorting competitive conditions.

Chapter 4 Action Plan for Reform

(1) Basic Concepts

Because of many restrictions on airlines pursuing free economic activities and inconvenience for consumers and shippers, the current Chicago Regime is an inappropriate framework. A new international aviation system should not consist of bilateral agreements but consist of a consistent set of rules agreed upon among many States.

(2) Action Plan Options

There are five options to achieve the reforms indicated in Chapter 3: ① revising the Chicago Convention, ②enacting a new universal treaty, ③enacting multinational agreements between States desiring liberalization, ④deepening and expanding liberalization through bilateral agreements, ⑤making international aviation transport subject to GATS.

① Revising the Chicago Convention : This is difficult to achieve in reality. In order to truly reform the existing Chicago Regime, the ideal solution might be to revise the Chicago Convention. However, Article 94 provides that any proposed amendment to this Convention must be approved by a two-thirds vote of the Assembly and shall then come into force in respect of States which have ratified such amendment when ratified by the number of contracting States specified by the Assembly and that . the number so specified shall not be less than two-thirds of the total number of contracting States. This

requirement is a very high hurdle against revision.

Concerning the concrete proposal, see 3.

② Enacting a new universal treaty

This alternative is to conclude a new multinational treaty that recognizes free aviation, setting aside the Chicago Convention. An agreement which has more liberalization than the existing International Air Transport Agreement must be enacted. We call it "new International Civil Aviation Agreement". There will be no differentiation between scheduled and non-scheduled flights. Contracting States also agree to remove restrictions on cabotage. The new International Civil Aviation Agreement will include provisions that do not hinder the free operation of aviation businesses. Following the enactment of the new International Civil Aviation Agreement, each contracting State shall abolish bilateral air agreements. The greater the number of States ratifying the agreement, the greater the effect is likely to be.

③ Enacting multilateral agreements between States desiring liberalization

This third alternative is more feasible than the first and second ones.These multilateral agreements should not be a regional agreement as regional agreements often discriminate third States outside the region.

④ Deepening and expanding liberalization through bilateral agreements

This alternative is practical and has the highest probability of being achieved. However, the effects on liberalization are likely to be extremely limited.

⑤ Making international aviation transport subject to GATS

This alternative is to promote liberalization within the framework of WTO. Under the current WTO system, air transport services are basically outside the scope of GATS (General Agreement on Trade in Services). The Annex on Air Transport Services provides that the Agreement shall not apply to measures affecting traffic rights and services directly related to the exercise of traffic rights. The Annex has to be completely amended. Given the recent paralysis of the WTO, it is not probable to achieve liberalization through this framework. Also, appropriate consideration for safety and national security might not be possible.

In conclusion, option ② is desirable among the five alternatives.

III. Analysis

Among the numerous topics involved, I would like to pick up the following 4 points for further analysis; (1) sovereignty over airspace, (2) application of competition law, (3) dispute settlement mechanism and (4) Japan's status quo and future options. My personal opinion might not necessarily coincide with the Report.

(1) Sovereignty over airspace

Article 1 of the Chicago Convention provides that every State has complete and exclusive sovereignty over the airspace above its territory. The freedom of the air is a kind of privilege based on treaties and it is not a right established under customary international law. The freedom of the air is quite different from the freedom of the ocean which includes the concept of innocent passage enjoyed by ships through territorial sea.

If we can revise Articles 1 to 7 of the Chicago Convention, I would like to propose the followings, although I have to put aside the feasibility.

①Article 1 : One option is to delete the phrase "complete and exclusive". The it will simply provides: "The Contracting States recognize that every State has sovereignty over the airspace above its territory." Another option is to add a new paragraph 2, which provides "The Contracting States shall make best efforts to recognize the over-flying and landing of foreign civil aircrafts without prejudice to the appropriate regulations based on security, safety or environmental considerations."

②Article 2 : The reminiscent words "suzerainty, protection or mandate" will be deleted.

③Article 4 : A new paragraph 2 will be added as follows : "Every

Contracting State shall take appropriate measures to ensure that its civil aviation is not used for the purpose and objective not in conformity with this Convention."

④Article 6 : In parallel with the new Article 1 paragraph 2, Article 6 will be amended as follows: "Every Contracting State makes best efforts to grant to the other Contracting State the freedom of the air in respect of (scheduled) international air transport."

⑤Article 7: This provision on cabotage will be simply deleted or provided as follows : "Every contracting State shall make best efforts to permit to other Contacting State to take on its territory passengers, mail and cargo separately or in combinations carried for remuneration or hire and destined for another point within its territory."

(2) Application of competition law

The alliance of major airlines is subject to the permission of both the US government and the EU Commission. From the point of international law, extraterritorial application based on effect doctrine does not necessarily have opposable effects on the addressee. However, the airlines will comply with the two authorities because otherwise they will lose the market in the US and in the EU.

Extraterritorial application of national laws (particularly the antitrust law and the export control law) have caused international frictions and disputed. Therefore, it is desirable to add rules on competition in the new Convention.

(3) Dispute settlement mechanism

So far, there are five international arbitration concerning the interpretation and application of bilateral air agreements: (i) US vs. France (1963), (ii) US vs. Italy (1965), (iii) US vs. France (1978), (iv)Belgium vs. Ireland (1981) and (v) US vs. UK (1992). Article 84 of the Chicago Convention provides that the disputes are first referred to the ICAO Council and then to an international

arbitration or to the ICJ. Considering that the number of disputes between non-State entities (particularly airlines) or disputes between a State and an airline is and will be increasing, the dispute settlement mechanism should be modernized to adapt to this trend and .I would like to propose the following : (i) As to disputes between States, panel (or arbitration) is established if one of the parties submits the dispute. Panel in the WTO settlement mechanism can be a useful model. (ii) As to the disputes between an airline (or airport company/authority) and a State, the former can submit the dispute to the panel (or arbitration) if the latter accepts jurisdiction of the panel (or arbitration). Provisions on dispute settlement contained in recent bilateral investment treaties, free trade agreements and the Energy Charter Treaty can be a useful model. (iii) As to the disputes between non- State entities (airline, airport company or authority and etc.), they should be referred to existing commercial arbitration forum like the International Chamber of Commerce. At any rate, these disputes should be settled by an international forum. Domestic courts are biased and they are not appropriate forum.

(4) Japan's status quo and future options

Japan has concluded 56 bilateral air agreements. Among them, most of those concluded until 1979 are Bermuda 1 type agreements, while most of those concluded after 1980 are agreements which have a predetermined capacity clause[5]. Japan has not yet concluded open skies agreements with other States, although she recently agreed to open local airports to airlines in Korea, Thailand, Hong Kong and Macao.

On 16 May 2007, the Council for the Asian Gateway Initiative, a consultative body to Prime Minister Abe, released its final Report "Asian Gateway Initiative." [6] In the Report, the priority is change in aviation policy to achieve "Asian Open Skies". The Report suggests that Japan should (i) form

5) As to the 56 agreements, see Kazuhiro Nakatani, Bilateral Air Agreements and Japan, Japanese Annual of International Law, No. 49 (2006), pp. 71-97.

6) The final Report is available at http://www.kantei.go.jp/jp/singi/asia/index.html

a strategic aviation network through aviation liberalization (Asian Open Skies), (ii) make Haneda Airport more international and (iii) facilitate 24-hour operation of major international airport.

As to (i), the Report suggests as follows:

- Recognize the formation of an international aviation network with other Asian countries as essential for invigorating regional economies and improving consumer convenience.

- Drastically change the traditional aviation policy in order to strategically promote the rapid liberalization of aviation ("Asian Open Skies"). The new policy is comparable to aviation liberalization taken place in the rest of the world yet different from the American-style "open skies policy."

- More specifically, promote aviation liberalization in order to remove restriction on carriers, entry points, and the number of both passenger and cargo flights.

With regard to Kansai International Airport and Central Japan International Airport, accelerate such liberalization through bilateral negotiation with Asian countries so as to allow increase of routes and flights that are suitable for their role as Japan's major international airports. At the same time, implement measures to strengthen the international competitiveness of these international airports, such as improving the networks between these and other Japanese airports and distributing functions among them.

- For local airports, accelerate ongoing liberalization negotiations and give provisional permission to increase routes and flights even before negotiations have been fully settled in order to promote tourism. Basically allow carriers to change their flights on notification basis (not subject to permission) with exception of procedures for safety verification, CIQ and coordination with the Self-Defense Forces. Promote international passenger charter flights which pave the way for introducing regular flights.

- Strategically utilize the airports in the metropolitan Tokyo area for the time being, while considering further liberalization, being mindful of the expanded capacity in the future.

- Start liberalization negotiations with China and other Asian countries (give

high priority to Asia).

As to (ii) and (iii), the Report suggests as follows :

- Make the most of international airports in major cities as important junctions connecting domestic aviation networks to overseas destinations, through promoting the use of late-night and early-morning slots (24-hour operation), whose usage is currently low.

- Further internationalize international airports in the metropolitan Tokyo area, even before the completion of ongoing re-expansion projects.

- Specifically, at Haneda Airport, which is the only airport in the metropolitan area operating in late-night and early-morning hours, promote international charter flights to and from Europe and the U.S. At the same time, initiate negotiations to accommodate international charter flights in specific time periods (departure at 20:30-23:00 and arrival at 6:00-8:30, which are off-peak hours). Implement every possible measure to make the most of the facility around the clock, such as one for improving late-night/early-morning access to the airport.

- In addition, increase the number of daytime departure and arrival slots to accommodate charter flights to and from Shanghai Hongqiao Airport and extra international charter flights to Beijing during the Beijing Olympic Games.

Also, make efforts to expand the temporary international terminal, enhance capacity for CIQ systems, and improve flight variety and transit connections on the routes linking Haneda Airport and overseas destinations via Kansai International Airport.

- Make airports more international by 2010 through re-expansion projects. Use departure and arrival slots to be added to Narita (20,000 slots annually) and Haneda (30,000 slots annually) Airports in a strategic and integrated manner.

The aim is to expand international networks of Tokyo metropolitan area, by enabling the smooth connection between domestic and international flights between the two airports, while improving access to both airports.

- Ensure that Haneda Airport is capable of serving 30,000 regular international passenger flights during the daytime upon opening of its

expanded facility.

Examine routes appropriate to Haneda from closer routes. The consideration will be based not only on distance (a conventional standard), but also on demands and significance of the routes, and they will be determined through aviation talks. For late-night and early-morning services, introduce regular international passenger and cargo flights (including those to and from Europe and the U.S.), with due consideration to noise pollution.

- In addition, discuss every possible way of expanding the capacity of airports in the metropolitan Tokyo area (Narita and Haneda Airports).

The Report suggests that Japan should conclude open skies agreements with Asian States. But the liberalization should not stop there. Among major States, only Japan and UK has not concluded an open skies agreement with US. Sooner or later, Japan will have to conclude an open skies agreement with the US. Also, Japan will have to choose to correct bilateral air agreements with the member States of the EU or to conclude a horizontal agreement with it.

IV. Final Remarks

As the Chicago Regime Research Committee Report suggests, some provisions of the Chicago Convention is outdated and should be updated. The same is true to Japan's air transport policy, as suggested by the Report "Asian Gateway Initiative."

The dawn is near for the new Chicago Regime as well as for the Japan's new air transport policy.