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Citation: 9 Minn. J. Global Trade 327 2000



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1998 Amendment to the U.S.-Japan Civil Air Transport Agreement: The Battle May Be Won, but the War for “Open Skies” Is Far from Over

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The United States and Japan took a significant step in liberalizing the Japanese civil air transport market by concluding the Agreement Between the United States and Japan Relating to and Amending the Civil Air Transport Agreement of August 11, 1952,¹ which entered into force April 20, 1998. Prior to the 1998 Agreement, only two passenger airlines from the United States and one from Japan, known as “incumbents,” enjoyed broad rights to travel between the United States and Japan and beyond.² The 1998 Agreement equalized the treatment of both countries’ airline industries by allowing the designation of two incumbents and four non-incumbents from each country.³ While the numbers and opportunities of non-incumbents were significantly expanded by the 1998 Agreement, it nonetheless may have jeopardized the possibility of eventually negotiating a true open skies agreement with Japan, which remains the ultimate goal of the United States.

This Note examines the 1998 Agreement and how it trades short-term expanded access to the Japanese market for any real hope of securing the ultimate goal of establishing a true open skies agreement with Japan.⁴ Part I outlines the importance and potential of the Asian Aviation Market. Part II examines the 1998 Agreement and the history of the negotiations that lead to its formation. Part III looks at the short-term signifi-

1. Agreement Between the United States and Japan Relating to and Amending the Civil Air Transport Agreement of Aug. 11, 1952, as Amended, with Memorandum of Understanding, April 20, 1998, *available in* 1998 WL 320120 [hereinafter 1998 Agreement].

2. See Arthur J. Alexander, *Transpacific Aviation Pact Yields Extensive Opportunities*, JEI REP. No. 7A, (Japan Economics Institute, Washington D.C.) Feb. 20, 1998.

3. *Id.* at 10.

4. See Derek Lick, *More Turbulence Ahead: A Bumpy Ride During the U.S.-Japanese Aviation Talks Exemplifies the Need for a Pragmatic Course in Future Aviation Negotiations*, 31 VAND. J. TRANSNAT’L L. 1207, 1215 (1998).

cance of the 1998 Agreement, and Part IV analyzes the Agreement's long-term implications. Part V concludes that while the 1998 Agreement provides minor incentives for Japan to return to the bargaining table when its four-year term expires⁵, the Agreement fails as a whole because it essentially gives Japan everything it could gain from an open skies agreement. Japan has only three major airlines, and each of them has gained nearly unrestricted access to the United States market through the 1998 Agreement.⁶ The Agreement leaves the United States with little bargaining power in future discussions regarding the further opening of the Japanese market.

I. POTENTIAL FOR GROWTH IN THE ASIAN MARKET

Notwithstanding the continuing economic hardships faced in Asia, there exists a large potential for growth and development of the airline industry in northeast Asia⁷, as well as new opportunities for U.S. carriers. South Korea and China are building new airports, in addition to a new airport recently completed in Osaka, Japan.⁸ In addition, the demand for air travel throughout the Asia/Pacific region grew at an average annual rate of more than ten percent between 1985 and 1995, the highest rate for any region in the world.⁹

In spite of the financial crisis, which has affected a number of Asian countries, the forecast for the long-term growth of air travel in the region remains optimistic.¹⁰ As recently as early 1997, the International Air Transport Association (IATA) forecast an average annual growth rate of 7.4% in the demand for air travel in Asia through 2010, a rate more than twice that for the rest of the world.¹¹ As a result, more than one billion passengers per year will be traveling to, from and within the Asia/Pa-

5. *Id.* at 1255.

6. *Id.*

7. Northeast Asia includes China, Chinese Taipei (Taiwan), Hong Kong, Japan, North and South Korea, Macau, Mongolia, and the Russian Federation east of the Urals.

8. See Nisid Hajari et al., *A Walk in the Clouds: The sleek lines of exciting new airports in Hong Kong and Kuala Lumpur sketch a vision of how Asia and the world will fly in the 21st century*, TIME INT'L, June 22, 1998, at 48+, available in 1998 WL 11649161.

9. See Air Transport Action Group [hereinafter ATAG], *Asia/Pacific Air Traffic Growth and Constraints (1997)* at 3, (visited Oct. 29, 1998) <<http://www.atag.org/ASIA/index.htm>>.

10. See Ian Jarrett, *Into a new dawn*, ASIAN BUS. (H.K.) Aug. 1, 1998, at 48, available in 1998 WL 14068503.

11. *Id.*

cific region by 2010.¹² The region increased its share of international scheduled traffic from 26.2% in 1985 to 36.2% in 1995, and forecasters see it reaching fifty percent by 2010.¹³ According to the forecast Japan will record a moderate growth of 4.4%, while China's total traffic will increase from 61.6 million passengers in 1995 to 291.5 million passengers in 2010, a 373% rise.¹⁴ Such a dramatic increase in Chinese air traffic means that the domination of the Asian market by Japanese travelers will continue to lessen through 2010.¹⁵

The current financial crisis in Asia has brought with it only a slight readjustment of the long-term forecast, though some of the immediate impact on the aviation industry in Asia has been severe.¹⁶ Aircraft manufacturers, such as Boeing of the United States and Airbus Industrie of Europe, stand behind their predictions for continued strong growth, which they place at 6.5% per year.¹⁷ In fact, by 2010, forecasts show some 1.1 billion passengers travelling within or to and from the Asian region—a projected fifty percent of world travel in 2010, and a figure equal to the total volume of world travel in 1995.¹⁸ In addition, new airspace agreements involving Russia, Mongolia and North Korea have reduced flight times for direct flights between North America and Asian destinations such as China and South Ko-

12. See ATAG, *supra* note 9, at 3.

13. *Id.*

14. *Id.*

15. *Id.* at 4.

16. See Jarrett, *supra* note 10, at 48. (In South Korea, the number two carrier, Asiana Airlines, has been forced to reduce its fleet, while Cathay Pacific of Hong Kong, which consistently ranks among the world's most profitable airlines, has seen profits drop fifty-six percent in the year 1997, and it faced a tougher year in 1998. *Id.* at 49. Philippine Airlines has suspended routes and faces labor cuts and a forced reduction in the size of its fleets to survive, while Indonesia's Garuda Airlines has been unable to stick to its delivery schedule of twelve Boeing 737's, three of which sit ready and waiting at Boeing's plant in Washington State. See Frederic M. Biddle and Diane Brady, *Asian Airlines Lower Growth Forecasts: Boeing and Airbus May Be Hurt by Economic Crisis*, WALL ST. J., Nov. 21, 1997 at B9B. Currency devaluations and a sudden slump in passenger demand have hit when many Asian airlines were expanding their fleets. *Id.* However, even though China's domestic airlines have piled up combined losses of US\$361 million in the first half of 1998, Ray Bracy, the president of Boeing China Inc., says, "We know that this is not the primary time for aircraft sales here in China." *China: Sluggish market hits aviation operations*, CHINA BUS. INFO. NETWORK, Oct. 5, 1998, available in 1998 WL 13494744. However, Boeing continues to forecast that nearly 1,800 aircraft will be needed in China in the next 20 years. *Id.*

17. See Biddle, *supra* note 16, at B9B.

18. See Jarrett, *supra* note 10, at 48.

rea.¹⁹ New alliances between American and Asian carriers also promise to facilitate access to the growing Chinese market.²⁰ Therefore, the Asian financial situation notwithstanding, the region's aviation market remains nearly unmatched in the world for growth potential.

In order for the United States to take advantage of the potential for growth in the aviation market throughout the Asia/Pacific region, it must negotiate aviation agreements with each country individually. International air traffic arrangements remain a complex collection of bilateral agreements not governed by the multilateral regime of the World Trade Organization (WTO), which generally governs international trade in goods and services.²¹ International aviation rights are categorized into what are commonly called the eight "freedoms" of the sky, which have been identified as the right of a civil aircraft or airline from one country to 1) fly over the territory of another, without landing, provided the overflown country gives its approval in advance; 2) land in the territory of another country for refueling, maintenance or other technical reasons, as long as no commercial passenger or cargo service is undertaken; 3) carry passengers and cargo from its home country to another country; 4) carry passengers and cargo from another country to its home country; 5) carry passengers and cargo between two countries not its home, as long as the flight originates or terminates in its home country (often referred to as "beyond" rights); 6) carry pas-

19. U.S. airlines may now take advantage of an agreement with Russia and Mongolia to offer direct flights with shorter flying times between the U.S. and China by flying over the arctic circle and down to China across Russian and Mongolian airspace. See *Northwest Airlines to Become First U.S. Carrier to Operate New Route Through Russian Airspace*, Northwest Airlines News Archive, Aug. 18, 1998 (visited Oct. 10, 1998) <<http://www.nwa.com/corpinfo/newsc/1998/pr081898b.shtml>>. See also *2 Koreas agree to open airspace to allow flights*, JAPAN TRANSP. SCAN, Oct. 13, 1997, available in 1997 WL 8250232 (noting that airlines that fly between North America and South Korea have been able to shave from 20 to 47 minutes off flight times by taking a short-cut across North Korean airspace, due to an agreement which was implemented in April of 1998).

20. See *Northwest Airlines, U.S. Partners, Form Alliances to Enhance U.S.-China Services*, Northwest Airlines News Archive, May 12, 1998 (visited Oct. 10, 1998). <<http://www.nwa.com/corpinfo/newsc/1998/pr051298a.shtml>>

21. See Ruwantissa I.R. Abeyratne, *Would Competition in Commercial Aviation Ever Fit Into the World Trade Organization?*, 61 J.AIR L. & COM. 793, 794 (May-June 1996). For a complete summary of the history and development of the current bilateral system see Rebecca E. Kreis, *A Comparative Analysis of the Aviation Network Within the European Community and the Ad-Hoc Network Between the United States and Central America*, 24 TRANSP. L.J. 303, 305-313 (Spring-Summer 1997). See also Abeyratne, *supra*, at 795-809.

sengers or cargo from one country to another with an intermediate stop in its home country; 7) carry passengers or cargo between points entirely outside its territory; and 8) carry passengers or cargo entirely inside the territory of another country (known as "cabotage").²² Because the United States must negotiate for the eight freedoms of the sky with each country individually, specific agreements can vary widely from country to country.²³

In 1944, the Convention on International Civil Aviation was held in Chicago, and while the United States sought the unilateral adoption of the first five freedoms, only the first two freedoms were included in the Chicago convention,²⁴ which has become the baseline for modern aviation agreements. An agreement is considered an "open skies" agreement if it extends at least the first five, if not all eight, of the freedoms of the sky.²⁵

The United States' push to establish bilateral "open-skies" agreements has gained momentum since 1992, when agreements were first signed with Canada and The Netherlands.²⁶ The number of such agreements rose to nearly thirty by 1997.²⁷ Taiwan, Singapore, Malaysia and Brunei, all of which signed open skies agreements in 1997, were the first countries from the Asian region to do so.²⁸

II. THE TERMS OF THE 1998 AGREEMENT

In January of 1998, the United States and Japan reached an agreement to amend the Civil Air Transport Agreement of 1952 after nearly two years of "arduous negotiations."²⁹ The original 1952 Agreement allowed "[a]n airline or airlines designated by the [g]overnment" of either the United States or Japan to operate air services on specified routes.³⁰ The 1952 agreement between the United States and Japan granted the first through

22. See Kreis, *supra* note 21, at 308-309.

23. See Daniel C. Hedlund, Note, *Toward Open Skies: Liberalizing Trade in International Airline Services*, 3 MINN. J. GLOBAL TRADE 259, 264-265 (1994) (discussing the bilateral nature of aviation negotiation agreements).

24. *Id.* at 265.

25. See Kreis, *supra* note 21, at 308 (describing the eight freedoms of the sky).

26. See Brian Reyes and Chris Gillis, *Bumpy flight toward open skies*, AM. SHIPPER 93, May 1, 1998, available in 1998 WL 10848781.

27. *Id.*

28. *Id.*

29. Alexander, *supra* note 2, at 1.

30. Civil Air Transport Agreement Between the United States of America and Japan, Aug. 11, 1952, U.S.-Japan, 212 U.N.T.S. 60, 78.

the fifth freedom rights to these designated carriers on specified routes.³¹ The designated carriers, also known as "incumbent"³² airlines, were Northwest and United³³ for the United States and Japan Air Lines for Japan.³⁴ Federal Express became the sole incumbent cargo-only carrier.³⁵

In the early 1980s, the United States argued that either party could designate any or all of its airlines as incumbents, "since the 1952 treaty explicitly used the plural, 'airlines.'"³⁶ Japan countered that such an interpretation went "well beyond the original intent of the agreement."³⁷ Japan insisted that no additional airlines should be granted the same rights as the incumbents. Eventually, however, the United States and Japan modified the original 1952 agreement through a series of Memoranda of Understanding (MOUs), to allow limited flights by non-incumbents American, Continental and Delta Airlines of the United States, and All Nippon Airways of Japan.³⁸ The flights by U.S. "non-incumbent" airlines were subject to weekly frequency limits, and they were denied any fifth freedom rights to carry passengers or cargo beyond Japan.³⁹

The disparity in the rights of the incumbent and non-incumbent airlines has had a significant economic impact on domestic regions which have consequently enjoyed or been denied access to Japan.⁴⁰ Since the U.S. incumbent airlines primarily served Japan from the American west and mid-west, the southeastern region was left without easy access to Japan. The thirteen

31. *Id.* at 62.

32. The 1998 Agreement refers to both incumbent and non-incumbent "combination" airlines. *See* 1998 Agreement, *supra* note 1, at 2 and 5. Combination airlines are authorized to operate combination passenger and cargo services, while incumbent and non-incumbent all-cargo carriers are authorized only to provide cargo services. *Id.* at 2 and 9.

33. While Northwest Airlines was an original incumbent, United purchased its incumbent rights from the other original incumbent, Pan American World Airways Co., in 1986. *See* Alexander, *supra* note 2, at 4.

34. *See* Michael Goldman, *U.S.-Japan Aviation Wars: Negotiating Not-Quite-Open Skies*, 12-SUM AIR & SPACE LAW. 1, 6 (Summer 1997).

35. Federal Express obtained its incumbent rights to carry cargo when it acquired Flying Tiger Line, Inc., which had been added as an incumbent cargo carrier after the original agreement. *See* Alexander, *supra* note 2, at 4.

36. Alexander, *supra* note 2, at 4.

37. *Id.*

38. *See* Goldman, *supra* note 34, at 6.

39. *Id.*

40. *See id.* (noting that the U.S. Airports for Better International Air Service (USA-BIAS) have calculated that an American city with a daily nonstop flight to Japan benefits from Japanese visitor spending, local foreign investment and export related jobs in the amount of up to US\$650 million per year).

southeastern states and Texas make up thirty-three percent of the total U.S. population, but only three percent of the nonstop U.S.-Japan airline flights serve that region.⁴¹ Furthermore, in spite of the additional flights subsequently granted to non-incumbents, U.S. and Japanese incumbent airlines carry eighty percent of all passenger traffic between the United States and Japan.⁴² This market dominance stems from their preferred status under the 1952 Agreement.⁴³ The disparity between the incumbent and non-incumbent airlines largely motivated the latest push by the United States for modification of the aviation agreement.⁴⁴ The United States initially hoped to broaden the scope of the previous Agreement into a complete open skies agreement with Japan.⁴⁵

From the beginning, Japan refused to accept an "open skies" interpretation of the 1952 Agreement or to replace the current understanding with a more explicit open skies agreement.⁴⁶ As is the case with other governments slow to implement open skies agreements, Japanese reluctance "stems in part from the knowledge that their inefficient, high-cost carriers cannot compete with U.S. airlines, honed by now by years of fierce, deregulated domestic competition."⁴⁷ As a result of the highly regulated Japanese domestic market, the operating costs of Japan's major airlines average sixty-six to eighty percent higher than those of competing U.S. airlines.⁴⁸ Even though bureaucrats from Japan's Ministry of Transport (MOT) concluded that the "only way to motivate more efficient operations was through greater competition," MOT negotiators envisioned a twenty-year time frame as appropriate.⁴⁹

In addition to refusing to extend unrestricted rights to non-incumbent airlines, Japan asserted that the "primary objective" of the 1952 Agreement was to provide for direct traffic between the United States and Japan.⁵⁰ Therefore, Japan insisted that passengers and cargo picked up in Japan and bound for other destinations should not exceed fifty percent of the total "beyond

41. *Id.*

42. See Lick, *supra* note 4, at 1228.

43. *Id.* at 1229.

44. See Goldman, *supra* note 34, at 6.

45. See Alexander, *supra* note 2, at 4.

46. See Lick, *supra* note 4, at 1228-33.

47. See Alexander, *supra* note 2, at 5.

48. See Lick, *supra* note 4, at 1235.

49. See Alexander, *supra* note 2, at 5.

50. *Id.*

traffic" aboard incumbent U.S. carriers.⁵¹ Japan's objective-oriented interpretation of the 1952 Agreement spurred its refusal to approve new beyond routes for incumbent Federal Express in particular.⁵²

In response to Japan's insistence upon a limited interpretation of beyond rights, the United States hoped to expressly clarify that beyond rights were unlimited, in addition to securing an open skies agreement.⁵³ Japan, on the other hand, viewed the original agreement as unfair because three U.S. airlines enjoyed incumbent status while only one Japanese airline enjoyed the same.⁵⁴ Therefore, Japan's first priority became the negotiation of an "equalization of rights."⁵⁵ The resulting 1998 Agreement seeks to accommodate all concerns on both sides.⁵⁶

The 1998 Agreement allows two airlines from each country to fly from any city in their home country to any city in the other's country and beyond, "without any limitation on frequency or capacity, and with respect to traffic composition without limitation except on passenger fifth freedom operations"⁵⁷ Japan advocated the limits on passenger fifth freedom

51. *Id.*

52. *Id.* at 6.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. 1998 Agreement, *supra* note 1 at 2. The 1998 Agreement limits fifth freedom operations by establishing formulas to ensure that U.S. and Japanese carriers do not exceed a certain proportion of their total passenger miles carrying traffic originating in the other party's country to third countries in Asia or the Americas. The passenger miles are aggregated on a system-wide basis over a six-month period. *Id.* at 3. The first formula, as applicable to U.S. incumbent airlines states, "Pax-miles (BC) <= pax-miles (AB) + pax-miles (AC)". *Id.* Where pax-miles are passenger miles flown, A is the United States, B is Japan, and C is any third country in Asia; this formula means that passenger miles from Japan to a third country in Asia must not exceed passenger miles between the United States and Japan. See Alexander, *supra* note 2 at 10. A second formula is "Pax-miles (AC) >= 25% pax-miles (BC)." See 1998 Agreement, *supra* note 1, at 3. This formula requires that of the total passenger miles terminating in the third country in Asia, the number of passenger miles from the United States to the third country must be greater than twenty-five percent of the number of passenger miles from Japan to the third country. See Alexander, *supra* note 2 at 10. A slightly different formula is used for traffic going beyond Japan to destinations in Europe or Africa, "Pax-miles (BC) <= pax-miles (AC)." See 1998 Agreement, *supra* note 1, at 4. In this formula, C is a European or African third country, and the passenger miles on the Japan Europe [or Africa] beyond segment must be less than the passenger miles of the people flying from the United States to Europe [or Africa]." See Alexander, *supra* note 2 at 10. The same three formulas also apply to Japanese carriers flying to the United States and beyond

operations from the start. The final formula, however, which is based on passenger miles rather than passenger counts, appealed to the United States. "Since the distances and the fares from the United States to Japan are considerably greater than those for Asian beyond routes, [and the agreed upon] formula would favor American carriers," the United States had a valid reason for demanding a formula like the one implemented.⁵⁸

In addition to allowing each country two designated incumbent airlines and establishing an explicit compromise position on beyond rights, the 1998 Agreement also deals with non-incumbent passenger airlines, codesharing agreements between airlines, and both incumbent and non-incumbent cargo carriers.⁵⁹ Japan and the United States may each designate four non-incumbent passenger airlines to operate between the two countries, and each country may add a fifth non-incumbent in the year 2000.⁶⁰ The non-incumbents receive additional non-restricted and restricted frequencies.⁶¹ According to the 1998 Agreement, each country's non-incumbents may split twenty-eight additional round-trip frequencies "regardless of any restrictions on designations or frequencies on those city-pair markets under the prior agreements."⁶² Another forty-two round-trip frequencies are allotted to each country's non-incumbents, except in certain city-pair markets.⁶³ Finally, non-incumbents are entitled to reallocation of frequencies provided to incumbents in prior agreements.⁶⁴ These would total twenty unrestricted frequencies.⁶⁵

In the area of incumbent all-cargo services, Japan did not achieve the same equalization under the 1998 Agreement that it had insisted on in passenger services.⁶⁶ The 1998 Agreement provides for designation of two Japanese airlines and three U.S. airlines as incumbent all-cargo airlines, namely Japan Airlines

to third countries in the Americas or to European/African destinations. *See* 1998 Agreement, *supra* note 1, at 4-5.

58. *See* Alexander, *supra* note 2, at 7.

59. *Id.* at 10.

60. *Id.*

61. *See* 1998 Agreement, *supra* note 1, at 6.

62. *Id.*

63. *Id.* The restricted city-pair markets are Tokyo/New York (not including Newark, New Jersey); Tokyo/Chicago; Tokyo/San Francisco (not including Oakland, California); Tokyo/Los Angeles; Tokyo/Honolulu; Tokyo/Guam-Saipan; Osaka/Los Angeles; Osaka/Honolulu; Osaka/Guam-Saipan; Nagoya/Honolulu; and Fukuoka/Honolulu. *Id.* at 6-7.

64. *Id.* at 7.

65. *See* Alexander, *supra* note 2, at 11.

66. *See* 1998 Agreement, *supra* note 1, at 9.

and Nippon Cargo Airlines for Japan and Federal Express, Northwest Airlines, and United Airlines for the United States.⁶⁷ Each country is allowed to designate one additional all-cargo airline beginning in 2002.⁶⁸ Cargo operations from both countries are "without any limitation on frequency, capacity, or traffic composition," and no formulas for restricting fifth freedom rights apply to incumbent all-cargo services.⁶⁹

Two U.S. all-cargo non-incumbent airlines were authorized by the 1998 agreement to operate frequencies previously granted.⁷⁰ United Parcel Service (UPS) is allowed to operate from any point in the United States to two points in Japan and two points beyond, while Polar Air Cargo will operate from any point in the United States to any two points in Japan and any one point beyond.⁷¹ Both countries are allowed to designate one additional non-incumbent all-cargo airline in 2002.⁷²

The 1998 Agreement also includes provisions for cooperative marketing arrangements such as codesharing.⁷³ While bilateral codesharing between Japanese and U.S. airlines is unrestricted, the agreement also provides for third-country codesharing with either party to the agreement, if the third country also allows codesharing arrangements with the airlines of the other party to the 1998 Agreement.⁷⁴ Originally, Japan sought to completely ban codeshare arrangements between airlines of the same country, arguing that in a case such as the Continental/Northwest alliance this would essentially allow a non-incumbent, Continental, to the enjoy all of the benefits of its incumbent partner, Northwest.⁷⁵ The compromise on same country codesharing in the 1998 Agreement provides that partner airlines of the same country may operate twenty-eight

67. *Id.*

68. *Id.* at 11.

69. *Id.* at 9.

70. See Alexander, *supra* note 2, at 11.

71. *Id.*

72. See 1998 Agreement, *supra* note 1, at 11.

73. *Id.* at 13. A codesharing agreement is a form of alliance whereby one airline sells seats on a partner airline's flight using its own two-letter code designation. See Kreis, *supra* note 21, at 313. Through codesharing, an airline can prepare an itinerary using its own flight numbers, even though one or more segments of the flight will be flown with a partner airline. This results in "a more favorable computer display when consumers look to purchase their tickets." *Id.* "There are many benefits from these links. The first and foremost is access to restricted markets. Following this are increased revenues, lower costs, new traffic, and "seamless" service." *Id.*

74. See Alexander, *supra* note 2, at 11.

75. See Lick, *supra* note 4, at 1257.

weekly round-trip frequencies under their codesharing arrangements.⁷⁶

One final significant issue dealt with in the 1998 Agreement is a provision for future negotiations.⁷⁷ The United States initially sought an open skies agreement with Japan, and it was reluctant to agree to anything that did not provide for further liberalization in the future.⁷⁸ As a result, the 1998 Agreement contains a provision that further negotiations must begin no later than January 1, 2001, "with the objective of fully liberalizing the civil aviation relationship between Japan and the United States."⁷⁹ The provision states that if the parties fail to reach an agreement by January 1, 2002, "additional opportunities shall become available."⁸⁰ The additional opportunities include seven new round-trip weekly frequencies available to non-incumbent passenger airlines in each of the years 2002, 2004, and 2005.⁸¹

III. THE SHORT-TERM SIGNIFICANCE OF THE 1998 AGREEMENT

The United States, backed by the incumbent airlines, initially sought nothing short of a complete open skies agreement with Japan.⁸² The incumbents pushed for an open skies agreement, even though they enjoyed broad rights under the 1952 Agreement, because they feared they might end up with fewer rights if the Japanese succeeded in their position to limit beyond rights.⁸³ The non-incumbent airlines, on the other hand, even with more to gain from an open skies agreement, supported a compromise, because they feared the talks could drag on indefinitely, and felt that getting something would be better than nothing.⁸⁴ Eventually, only Northwest, whose incumbent status helped the airline control one-third of all U.S.-Japan flights, held out in opposition to a compromise.⁸⁵ The airline was accused of holding out for open skies simply to preserve its large

76. See 1998 Agreement, *supra* note 1, at 16.

77. *Id.* at 18.

78. See Lick, *supra* note 4, at 1254.

79. See 1998 Agreement, *supra* note 1, at 18.

80. *Id.* at 19.

81. *Id.*

82. See Lick, *supra* note 4, at 1246.

83. *Id.*

84. *Id.*

85. See Alexander, *supra* note 2, at 7-9.

market share as an incumbent, since “[b]y insisting on the unattainable, the status quo was assured.”⁸⁶

When the final deal was struck, however, the United States gained more than expected, as the main airline beneficiaries were U.S. carriers, and each of the U.S. airlines involved, except Northwest, benefited significantly.⁸⁷ Even Northwest arguably got something, however, since liberal beyond rights were explicitly set forth in the 1998 Agreement, and also because Northwest is allowed the benefit of its same-country codesharing arrangement with Continental as well.⁸⁸

At the announcement of the 1998 Agreement, both Japan Airlines, an original incumbent, and All Nippon Airways (ANA), which was newly elevated to incumbent status, were disappointed.⁸⁹ Even before the 1998 Agreement, the greater cost efficiency of the U.S. airline industry in general had given U.S. carriers a competitive edge that helped them acquire a majority share of the U.S.-Japan traffic.⁹⁰ In fact, while the United States has had a growing trade deficit with Japan overall, the U.S. economy has had an annual trade surplus of over five billion dollars per year in the aviation sector.⁹¹ In reaching the 1998 Agreement, the Japanese government hoped that their nation's airlines would be given an incentive to become more efficient, as this “kind of ‘tough love’ may be in the long-term best interest of the industry and certainly of the Japanese flying public and shippers.”⁹²

Even with the closing of the 1998 Agreement, significant implementation obstacles needed to be cleared before any real benefits could be realized. Regardless of the 1998 Agreement's route and frequency guarantees, the final factor controlling whether a U.S. airline—incumbent or not—can actually add flights is the availability of takeoff and landing slots at Japanese airports.⁹³ Well before the 1998 Agreement was finalized, “it was apparent that the number of desired flights to and from Narita⁹⁴ exceeded

86. *Id.*

87. *Id.* at 11.

88. *Id.*

89. *Id.*

90. See Lick, *supra* note 4, at 1223.

91. See Goldman, *supra* note 34, at 6.

92. Alexander, *supra* note 2, at 12.

93. *Id.* at 10.

94. See generally Dave Knibb, *Narita Slots Scramble*, AIRLINE BUS. 28, Aug. 1, 1998, available in 1998 WL 11817282. (noting that Narita International Airport, which serves Tokyo, is the third busiest airport in Asia, and is used by more than half of all passengers en route to or from Japan).

the airport's theoretical capacity."⁹⁵ Northwest had warned that "additional frequencies granted without the slots to back them up were only 'paper rights.'"⁹⁶

While the question of slot availability did not become an explicit part of the 1998 Agreement, Japan's Ministry of Transport (MOT) quickly devised a plan to satisfy the U.S. carriers in order to make the deal a success.⁹⁷ Through reallocating unused slots⁹⁸ and raising slot limits,⁹⁹ the Japanese MOT has created some two hundred new slots at Narita since the 1998 Agreement.¹⁰⁰ Japan's airlines have complained that the United States—whose share of Narita's total slots went from thirty-four percent before the 1998 Agreement to thirty-seven percent after¹⁰¹—controls far too great a share already.¹⁰² The opening of a second runway at Narita, planned to be completed in 2000,¹⁰³ will increase capacity by seventy-two percent, allowing for 260 more takeoffs and landings each day.¹⁰⁴ Competition for this new capacity is sure to be fierce.¹⁰⁵

IV. THE LONG-TERM IMPLICATIONS OF THE AGREEMENT

While U.S. airlines seem to have clearly won benefits for the life of the 1998 Agreement, it is less clear whether the Agree-

95. See Alexander, *supra* note 2, at 10.

96. *Id.*

97. *Id.*

98. *Id.* Japan adopted a "use it or lose it" rule, whereby unused slots allocated to one airline might be taken away and reallocated to another airline of the same country. *Id.* Federal Express had a number of unused slots, but rather than take them without compensation, the Japanese MOT allowed Federal Express to transfer them to other U.S. airlines for compensation. *Id.*

99. See Knibb, *supra* note 94, at 2. Narita's airport authority secured an agreement with Japan's air traffic controllers union to allow an increase in the hourly rate from twenty-eight to thirty takeoffs or landings. *Id.* The three-hour limit was raised from seventy-five to seventy-nine and the daily limit from 360 to 370 takeoffs or landings. *Id.*

100. See JAL, *United Defend Narita Slot Situation, Push O'Hare Bids*, AVIATION DAILY 52, Jan. 11, 1999, available in 1999 WL 9481645. The measures for the accommodation of more slots for U.S. airlines under the 1998 Agreement has drawn criticism from third party countries, particularly the United Kingdom, claiming that the United States has been given preferential treatment. See Knibb, *supra* note 94, at 3.

101. See JAL, *United Defend Narita Slot Situation*, *supra* note 100, at 52.

102. See Knibb, *supra* note 94, at 2.

103. See Andrzej Jeziorski, *JAL realigns to face aggressive market*, FLIGHT INT'L Jan. 27, 1999, available in 1999 WL 10230685, at 3.

104. See Knibb, *supra* note 94, at 1.

105. *Id.*

ment provides any advantage in reaching the long-term goal of achieving open skies. Japanese airlines were disappointed in the 1998 Agreement when it was announced because they viewed the agreement as exposing Japanese carriers to too much competition, too soon.¹⁰⁶ In fact, shortly after the 1998 Agreement was announced, Standard and Poor's justified the airlines' disappointment by placing Japan Airlines on its watch list for possible downgrading. S & P cited the increased competition Japan Airlines would face as a result of the 1998 Agreement, the new runway opening in Narita, and also the carrier's high cost structure in justifying the downgrade.¹⁰⁷ In addition, ANA complained that while the Japanese MOT had found additional slots for U.S. non-incumbents, "its new status as an incumbent . . . [would] remain largely symbolic," unless more slots were given to ANA.¹⁰⁸

In spite of the negative consequences that concerned Japanese carriers under the terms of the 1998 Agreement, Japan Airlines returned to profitability in the 1998-99 fiscal year, and the airline predicted it would be able "to pay its first shareholder dividends in six years."¹⁰⁹ In addition, Japanese and U.S. airlines have reached a number of codeshare agreements provided for in the 1998 Agreement.¹¹⁰ Moreover, when the new runway opens at Narita, Japanese airlines are expected to be awarded half of the new landing slots.¹¹¹

If Japanese airlines are able to improve their cost structure and overall competitiveness, the picture is even brighter for Japan.¹¹² By a three-to-one margin, Japanese travelers prefer to

106. See Alexander, *supra* note 2, at 11-12.

107. See *S and P puts JAL on watch list for possible downgrade*, JAPAN TRANSP. SCAN, Mar. 16, 1998, available in 1998 WL 8030637, at 1.

108. See Knibb, *supra* note 94, at 1.

109. See Jeziorski, *supra* note 103, at 3.

110. See *Profile: Japan's Air Transport Industry* (Feb 1999), ASIA PULSE, Feb. 9, 1999, available in 1999 WL 5084464, at 6. Japan Airlines has reached a codeshare agreement with American Airlines. See *JAL and AA reach agreement*, JAPAN ENERGY SCAN Mar. 2, 1998, available in 1998 WL 9326831, at 1. ANA has announced an agreement with United. See *ANA announces tie-ups with United, Lufthansa*, JAPAN TRANSP. SCAN Mar. 16, 1998, available in 1998 WL 8030630, at 2. In addition, Japanese non-incumbent Japan Air System (JAS) has formed an alliance with Northwest. See *Northwest Airlines Uses Flexibility Afforded by the new US.-Japan Aviation Agreement to Restructure its Asia Route Network*, July 20, 1998, (visited October 10, 1998) <<http://www.nwa.com/corpinfo/newsc/1998/pr072098a.shtml>>.

111. See Lick, *supra* note 4, at 1262-1263.

112. The increased service between the United States and Japan as a result of the 1998 Agreement has led both Japanese and U.S. airlines to cut fares, and the competition has forced at least one newly designated non-incumbent,

fly on Japanese airlines, a significant factor, considering Japanese travelers and other foreign nationals make up over eighty percent of the passengers traveling between the United States and Japan.¹¹³ It is also important to note that Japanese airlines also have an advantage in dealing with Japanese tour wholesalers due to the structure of the Japanese travel market.¹¹⁴

V. CONCLUSION

While U.S. airlines, especially the designated non-incumbents, may have realized substantial gains through the compromises reached in the 1998 Agreement, the struggle for an open skies agreement and its concomitant benefits is far from over. Furthermore, while Japanese airlines came away from the 1998 Agreement expressing disappointment, cutting costs and improving competitiveness will place them in a very advantageous position for the long term.

The vast majority of travelers between the United States and Japan are Japanese. This large group of travelers prefers Japanese airlines over foreign carriers, and with the leverage Japanese carriers enjoy with Japanese domestic tour wholesalers, the United States must yet surmount a significant obstacle to ensure its position in the Japanese market.

In spite of the gradually increasing frequencies guaranteed by the 1998 Agreement, if the latest agreement expires without a new one to take its place, the United States has little leverage to bring the Japanese back to the bargaining table, since all of Japan's major carriers now enjoy broad rights under the equalization extended by the 1998 Agreement.¹¹⁵

In addition to U.S. bilateral efforts for open skies, there is a possibility of a multilateral effort for the same. The European Commission is bringing an action against eight member states for negotiating bilateral open skies agreements with the United States claiming the Commission has a mandate to "negotiate a

Trans World Airlines, to postpone its entry into the Japanese market. See *Japanese and US Airlines Cut Economy Class Fares*, AIRLINE INDUS. INFO., Feb. 24, 1999, available in 1999 WL 10468519, at 1.

113. See Lick, *supra* note 4, at 1263.

114. *Id.*

115. Japan has only three major airlines which account for nearly 90 percent of domestic market share and two of them are incumbents, while the third, Japan Air System, has a codeshare agreement with U.S. incumbent Northwest. See *Profile: Japan's Air Transport Industry* (Feb 1999), *supra* note 110, at 6.

comprehensive EU-U.S. aviation agreement.¹¹⁶ Japan is not a member of any economic union, however, and while there has been talk of eliminating the bilateral regime of aviation agreements and bringing it under the World Trade Organization, national interests keep this a long way in the future.¹¹⁷ Therefore, the United States will probably have to negotiate any further liberalization on a bilateral basis, without much incentive for Japan to cooperate.

The United States should have bargained for a more certain open skies outcome. Part of an effective strategy for securing open skies agreements includes assigning the "highest priority to negotiations that seek to open markets, and a lower priority to those that seek a continuation of bilateral restrictions."¹¹⁸ The United States should avoid wasting efforts on negotiations seeking "only incremental changes using a traditional balance of benefits approach."¹¹⁹ Experience shows that even if these negotiations break down, the United States may not be seriously disadvantaged, and the benefits of success are worth the wait.¹²⁰

A number of U.S. airlines benefited from the 1998 agreement, but the United States retained little leverage to bring Japan back to the bargaining table for further liberalization. For this reason, even though the United States may have won the battle with the 1998 Agreement, the war for open skies is far from over.

116. See John R. Schmertz and Mike Meier, *EU Brings Action Before ECJ Against 8 Member States Over Their "Open Skies" Agreements With U.S.*, 4 Int'l L. Update 135 (Nov. 1998). The EC brought the action against Austria, Belgium, Denmark, Finland, Germany, Luxembourg, Sweden, and the United Kingdom.

117. See generally Abeyratne *supra*, note 21.

118. See Michael F. Goldman, *Modest Proposal for a Short-Term U.S. International Aviation Negotiation Strategy*, 8-WTR Air & Space Law., Winter 1994, at 6, 11.

119. *Id.*

120. *Id.* "Over the last decade, the United States has come to live with comity and reciprocity regimes [after being unable to negotiate] with Brazil, Thailand, Peru and most recently France." *Id.* "No shutdown of airline services resulted in any of these cases." *Id.*