Open skies – a global view

01/02/2001

The thousands and thousands of bilateral and multilateral agreements in place throughout the world may be an antiquated way to carve up aviation rights among the nations of the world, but it seems as if a better way ahead is still out of reach.

The politics of awarding airline rights are dazzling in their intransigence. Take, for example, the failure of the UK and the US to negotiate an open-skies agreement.

Talks on liberalizing transatlantic traffic have collapsed amid recriminations of protectionism. But hopes that a new US president in the White House may signal an era of rapprochement could prove premature.

Relations between US Department of Transportation (DoT) officials and their UK counterparts reached an all-time low late last year when members of the outgoing US administration accused UK negotiators of deliberately evading an agreement on transatlantic airline rights.

Traffic is governed by Bermuda II, condemned by Graeme Leach, chief economist at the UK-based Institute of Directors, as a ?dinosaur in an age of cyberspace?. Bermuda II permits only two UK (BA and Virgin) and two US carriers (American and United) to fly transatlantic routes out of Heathrow, which, according to US officials, guarantees market share for the UK carriers. US officials were immediately backed up by the IoD, which in a report by Leach accused the UK government of pursuing an anticompetitive policy.

However, American policy also has its critics. Kenneth Button, former head of aviation policy at the OECD, argues that: ?America?s closed domestic market weakens the US negotiating position abroad. America seeks to open international markets through its open-skies initiative while keeping the world?s largest domestic market closed to foreign competition.? This, says Button, means denying cabotage to non-US carriers or the right to own more than 25% of a US domestic airline, whereas in fact, ?genuine economic deregulation requires open access to the entire air transportation market?.

Andrew Lobbenburg, equity analyst at JP Morgan, agrees. ?The agreement between Singapore Airlines/ New Zealand, et al, is the US version of how an open-skies agreement should be. It does not touch the US domestic market.?

The UK government has long opposed the US insistence that any open-skies agreement include a guarantee of beyond rights for US carriers. However, since 1995, the DoT has successfully pursued bilateral agreements with 10 European Union (EU) states. Martin Staniland in the European policy paper, Open Skies ? Fewer Planes?, points out that both the Carter and Clinton administrations ?have openly adopted a divide-and-rule tactic in dealing with the EU... they hope that more liberal agreements would put pressure on the UK?. These agreements typically allow US carriers to fly to any point in the partner country, with no restrictions on frequency and, most importantly, with beyond rights. This, Button points out, allows US carriers to offer services between a number of European cities, and so ?enjoy a limited form of cabotage within the EU market?. Lobbenburg agrees. ?The US has got the EU market nailed. US carriers are already allowed to fly between other European capitals, so they are not going to gain an enormous amount through reaching a deal with the UK,? he says.

But Leach believes that it is wrong for UK negotiators to compare the EU domestic market with the US. ?Under EU law, the UK cannot grant cabotage rights even within the UK... the UK is claiming cabotage rights within the US, even though it cannot provide them to a US carrier.? Such objections also apply to US restrictions on foreign ownership. ?The UK is asking for liberalization of the US market, although liberalization falls under the remit of EU law.?

Back in the US, Bush has appointed ex-Democrat Norman Mineta as transportation secretary with a mandate to include revitalizing talks with the UK on an open-skies agreement (see Diary, page 5). The changeover will also include the departure of Joel Klein, named by Antony Bor, transport analyst at Merrill Lynch, as belonging to the ?bulldog school of negotiations?. In the UK, there is also a new chairman at BA. According to Bor, these key personnel changes, combined with a greater ideological commitment to liberalization in the US, ?may spur a more helpful attitude on both sides?. But Lobbenburg is less optimistic. ?The same key obstacles that were facing negotiators are still there,? he says.

All content © Copyright 2026 AFG, all rights reserved.

US air services policy in Asia

The most important ASA developments for Asian carriers and, indeed, for carriers anywhere in the world, are those that involve the US. Home to by far the world?s largest air transport industry, the US has long pursued a policy of open skies, including in Asia. According to analysts, this approach, seemingly rooted in equality and fairness, puts Asian carriers at an increasing disadvantage vis-à-vis US operators.

US DoT definition of open skiesn

- open entry on all routes;
- unrestricted capacity and frequency on all routes;
- unrestricted route and traffic rights, including no restrictions as to intermediate and beyond points;
- pricing flexibility;
- liberal charter arrangements;
- liberal cargo regime;
- ability to convert earnings and remit in hard currency promptly and without restriction;
- open code-sharing opportunities;
- self-handling provisions (the right of a carrier to perform and control its airport functions in support of its operations);
- pro-competitive provisions on commercial opportunities, user charges, fair competition and intermodal rights; and
- explicit commitment to non-discriminatory operation of, and access to, computer reservation systems.

Although the open-skies initiative appears to mark a shift towards liberalization, the DOT incorporates many established elements of previous bilateral air transport agreements into its open-skies definition. Crucially, notes Chin Lim at Morgan Stanley, the DOT has been generally loath to liberalize existing provisions regarding cabotage or foreign investment.

In an effort to protect its domestic market from being swamped by foreign carriers, the US prohibits cabotage and, in this respect, it is little different from most other countries. But US carriers, because of the unique geography and importance of the US market, have been able to achieve what might be called regional cabotage, in the Asia-Pacific region, without facing cabotage in the US. So, while a US carrier might theoretically fly from Sydney to Manila and then to LA, picking up passengers on the way, Philippine Airlines is not able to pick up passengers in New York, stop off in Seattle for more on route back to Manila. Airlines such as Cathay Pacific, or indeed PAL, geographically situated between major origin and destination markets, rightly feel the most threatened by the US approach. It is no coincidence that Hong Kong has been one of the toughest negotiators in the Asian arena for US DOT officials.

The DOT has a valid response: why should the US grant foreign carriers greater access to the immense US aviation market without corresponding benefits in return? But valid or not, it is revealing that US carriers? combined share of the international market has grown substantially in recent years. In 1998, US airlines captured a 54% share of the total international aviation market, representing a growth in market share of 7% since 1990. While there are many ways of determining market share, the US?s open-skies approach is no doubt one contributing factor.

US carriers hope to achieve similar market share gains in Asia to those they achieved in Europe in the past five years. In that period, the percentage of non-US citizens on US-flown transatlantic flights has risen from 24% to 40%.

Because the US market is so important to international carriers, US negotiators are in a uniquely strong position, says Chin Lim. Yet, despite the fact that the US holds the trump negotiating cards, it has met recent resistance from Asian nations during liberalization talks.

All content © Copyright 2026 AFG, all rights reserved.

Notably, at the end of October last year, Srisook Chantrangsu, permanent secretary for transport and communications in Thailand, denounced a US proposal to free-up airline services as unacceptable. But Thailand could turn out to be the loser by its insistence on not opening the doors further to US operators. A source in the Thai Ministry of Transport and Communications admits that, as a result of Thailand?s tough stance, the US had relocated part of its aviation business to Singapore where the aviation regime is more liberal.

The solution for Asian operators would be to negotiate with the US as a combined entity. The Orient Airlines Association, the predecessor to the Association of Asia-Pacific Airlines, tried to negotiate on behalf of its member states in talks with non-member countries, observes one analyst, but that programme eventually fell apart. ?Until Asian airlines get together and tackle US ASA policies jointly, they are going to be at a significant disadvantage,? he concludes.

Asia

Asia, the world?s fastest-growing region in aviation, is expected to see the most dynamic ASA change and evolution going forward. However, despite the occasional efforts of international forums such as Apec and Asean, this evolution is likely to occur on an ad hoc rather than coordinated basis. According to Assad Kotaite, president of the Council of the International Civil Aviation Organization (ICAO), the liberalization of international air transport is progressing in Asia as elsewhere, on the basis of the specific needs, interests and circumstances of individual states. So far, this has proved to be satisfactory, at least as far as Asian governments are concerned.

The once-mooted idea of applying the liberalizing measures contained in the general agreement on trade in services (Gats) to the world of air service agreements has not been seen as a necessity by states, says Kotaite.

Although liberalization measures are undoubtedly a good thing for the airline industry at large, recent history has shown that new air service agreements can create losers as well as winners among the airline community. Over the past seven months, a large number of changes have occurred in the Asian aeropolitical environment. These changes include: a new agreement between Japan and South Korea to increase daily flights between Seoul and Narita and other Japanese cities, starting in May 2002; a new bilateral air services agreement between Australia and Sri Lanka; bilateral air service agreements signed by India with Mauritius, Oman and Syria; and the agreed trial application of a revised air services system between China and Vietnam.

The expansion of the ASA between South Korea and Japan is one of the more significant developments in the past 12 months, say analysts, because the South Korea/Japan market is one of the region?s busiest. Two million Japanese passenger trips and one million South Korean passenger trips are made to each other?s countries every year. The revised ASA will help to expand the revenue base for Japanese and South Korean airlines, provided that the market between the two countries does not stagnate. For other carriers, the ASA is largely a neutral development.

Formosa, or Taiwan as it is more commonly known, is a unique case in both international politics and aviation. Because of its long stand-off with the People?s Republic of China (PRC) and because of Beijing?s efforts to isolate the island diplomatically, the island lacks direct air links with a number of countries, the PRC included. One of the most significant potential changes to the aviation aeropolitical landscape in the near future is the possibility of direct links between China and Taiwan. When, and if, direct links materialize, they are likely to bring substantial operating and financial benefits to Chinese and Taiwanese carriers and fresh competitive threats to airlines such as Dragonair, Cathay Pacific and Air Macau which benefit from the flow of Taiwanese citizens into Hong Kong and Macau, on voyage to destinations in the mainland.

In December, in an effort to improve relations with China, Taiwan?s government approved direct transport links between its outlying islands and the Chinese mainland. In itself, the move is not significant for the airline industry ? only a tiny fraction of Taiwan?s populace lives on these islands and most journeys between the outlying islands and mainland China are likely to occur by ship.

But the Taiwan government puts a different spin on the development than most independent observers do. One official at Taiwan?s Ministry of Transportation and Communications says: ?The move may not have a great impact on the airline business right now, but it is important simply as a significant step on the road to direct links.?

Perhaps. But the next step, direct air links to Taiwan proper, will be a much more difficult process given the obvious security concerns of the Taiwanese. ?The problem,? says Chin Lim, managing director of Morgan Stanley Dean Witter?s Asian aviation research team, ?is that Taipei is afraid direct passenger links will lead to an influx of Chinese, many of whom might try to stay in Taiwan, effectively as illegal immigrants. Taiwan?s government hasn?t really worked out how to solve this issue.? Under the present system of direct links to Taiwan?s outlying islands, Chinese visitors cannot leave the outlying islands, except to go back to China.

All content © Copyright 2026 AFG, all rights reserved.

This still leaves the way open for direct air cargo links, and Chin Lim suspects that cargo links will be approved much more rapidly than passenger links. On the passenger side, despite the optimism often expressed by Taiwanese carriers that direct air links are just around corner, most analysts agree that they are still at least two years away.

The impact of direct links

Assessing the impact of direct links on Hong Kong, Macau, mainland Chinese and Taiwanese carriers is complex. But there is no doubt that, for several of the carriers in the greater China domain, the impact on operating results will be significant.

In terms of cargo, indirect trade between Taiwan and mainland China is worth about $25.8 billion. In 1999, nearly 40% of this total (according to some economists substantially more than 40%) travelled through Hong Kong.

In terms of passenger traffic, 1.8 million Taiwanese visited Hong Kong in 1998. The Hong Kong tourist office says that more than half a million of these visitors (or 28%) were in Hong Kong on transit to mainland China. Assuming that half the 500,000 Taiwanese visitors travelling through Hong Kong chose to fly direct, and assuming an average ticket price of about $470 per person, a market worth at least $117.5 million a year could be lost to Hong Kong?s carriers on the Taiwan to Hong Kong leg alone. In fact, because the ticket price is based on Cathay Pacific?s online economy ticket price, round trip from Taipei to Hong Kong, it is undoubtedly an underestimate of average ticket prices and, therefore, total revenues.

For Taiwanese and Chinese carriers, the market size to be won is potentially much larger still, not least of all because direct air links would involve much longer flying distances than the relatively short Taiwan to Hong Kong route.

Hsieh Ching-lung, EVA?s Beijing office planning director, says that the potential market, including cargo, could be worth as much as $3 billion a year.

Cathay Pacific controls about 32% of the Hong Kong air travel market at the moment. If this is indicative of its share of the Taiwanese visitor market, lost revenue for Cathay Pacific, based on the $470 ticket price average, could be about $38 million a year ? a surprisingly small 1.3% of its expected 2001 passenger revenues. Chin Lim also argues that many premium-class passengers would still transit or stop over in Hong Kong, mainly for shopping purposes, even if direct links were available and the passengers were travelling between Taiwan and mainland China. Cathay should still be able to maintain a large percentage of the high-yield market.

One direct links scenario outlined by a Hong Kong-based analyst forecasts that the new market would be split between two mainland Chinese and two Taiwanese carriers. China Eastern Airlines (CEA), he says, would be a very likely contender for one of the mainland Chinese slots in the direct links market. Assuming CEA could compete effectively with the Taiwanese carriers and secure a quarter of the market, it would be able to bring in about $29 million in extra passenger revenues (again based on the conservative estimate of $117.5 million for total market size), adding an extra 3% to its predicted 2001 passenger sales base.

The prolonged stand-off between China and Taiwan is also largely responsible for the fact that neither Taiwanese nor South Korean carriers fly direct between Taiwan or the Korean peninsula. Seoul had to sever its direct flight services ties with Taiwan in 1992 when it switched diplomatic recognition to Beijing.

But, in the past few months, the South Korean government has stated that the restoration of flight services to Taipei is a priority in 2001. In fact, direct air services between the two countries do exist, courtesy of Thai Airways and Cathay Pacific, which have permission to operate on the Seoul/Taipei leg.

South Korean and Taiwanese carriers would be revenue winners at the expense of Thai and Cathay, if direct services operated by South Korean or Taiwanese carriers emerged in the near future.

In contrast to South Korea?s obvious optimism, Taiwan?s government is sceptical that direct links are likely in the near term. ?Seoul,? says one government official, ?is counting heavily on the PRC to help bring North Korea to the peace talks table, and is shying away from opening official negotiations with Taiwan for fear of offending Beijing.?

All content © Copyright 2026 AFG, all rights reserved.

Thank you for printing this article from Airfinance Global, your essential intelligence resource for aviation finance. If you have been given this article by a subscriber, you can contact us through email at accountmanager@airfinanceglobal.com or call us on +44 (0)20 7779 8015 to discuss our subscription options.

All content © Copyright 2026 AFG, all rights reserved.