



**Center for a  
New American  
Security**

**Taking Off  
Civil Aviation, Forward Progress  
and Japan's Third Arrow Reforms**

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## Taking Off

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### EXECUTIVE SUMMARY

Civil aviation has long been a critical aspect of the Japanese economy. Two national carriers, Japan Airlines (JAL) and All Nippon Airways (ANA), dominate the industry. Both of these airlines have vied for market control of Japan since the mid-1980s, following considerable government deregulation and the privatization of Japan Airlines. Japan has continued to maintain tight control over its aviation market, creating barriers for both domestic firms and foreign competitors through tolerating political coordination, protectionist policies, and limiting landing slots and airport access. These prohibitory measures have created a skewed and uncompetitive market space. Current regulations are incongruous with facilitating increased exposure and competitiveness for the Japanese aviation market in the international arena.

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Many of the world's political and business communities have grown accustomed to the bureaucratic roadblocks and political protections found in the Japanese economy. Following decades of such practices, many foreign firms have come to see these tactics as 'business as usual,' a set of cautionary tales for foreign investors. Yet in December 2012, the Liberal Democratic Party of Japan (LDP) won a momentous victory, ousting the Democratic Party of Japan (DPJ) that had held control since its historic takeover of the Diet in 2009. At the LDP's helm sat Shinzo Abe, an LDP political heavyweight and former Prime Minister of Japan from 2006 to 2007. Within weeks of his party's dominating election and his return to the seat of the Prime Minister, Abe announced a bold plan to revitalize and reinvigorate the Japanese economy after two decades of economic stagnation and currency deflation.

This strategy has been dubbed 'Abenomics,' a sweeping plan promising economic revitalization through "Three Arrows" of reform efforts. The first two Arrows incorporate a program of quantitative easing and a subsequent public works spending agenda to help stimulate the economy through traditional Keynesian methods. Abe's Third Arrow is by far the most significant factor in encouraging progress and reversing Japan's longstanding economic malaise through structural reform. The Third Arrow endeavors to promote private investment-led growth by opening Japanese markets and encouraging a more flexible and competitive regulatory framework for firms both foreign and domestic. Two targeted sectors that Abe has identified as critical to Japan's economic recovery, reform, and expansion are foreign direct investment and tourism.

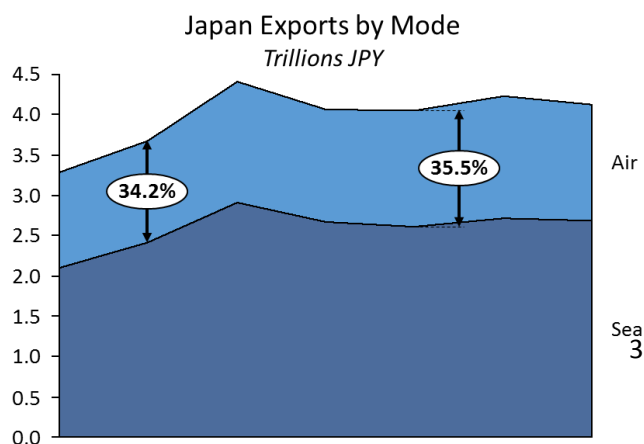
Japanese civil aviation is strongly interconnected with the industries Abe intends to reform by linking Japan's economy with the outside world. Abe's Third Arrow has the ability to target the protectionism, politicization, and opaque regulations that plague the Japanese aviation industry. By addressing these systemic uncompetitive impediments, Abe can simultaneously revitalize the Japanese economy and prove to the international community his commitment to forward progress. In many ways, the symbolism and benefits of true structural reforms in the Japanese civil aviation sector are a litmus test for the credibility of the Third Arrow.

## THE JAPANESE CIVIL AVIATION SECTOR

In order to better comprehend the current political climate in Japanese aviation, it is important to understand its historical antecedents. The history between the major players in commercial aviation, particularly after Japan Airlines' full privatization in 1987, is crucial to understanding the current competitive environment.

The 'coopetition' between Japan Airlines and All Nippon Airways animates not only the current but also the early history of Japanese civil aviation. In August 1945, General Douglas MacArthur instituted 'Order No. 1.' Circulated by the Imperial Headquarters in September 1945 after Japan's surrender, the ban was made with the intention to "prevent any possibility of Japan preserving an air force nucleus for future aggression, [and in doing so] outlawed all operation of private aircraft."<sup>1</sup> Following seven years of country-wide groundings, the ban on Japanese civil aviation was lifted with General Order 10 on April 28, 1952, which followed the conclusion of the Treaty of Peace with Japan.<sup>2</sup> These two firms were established soon after the ban was lifted, and they quickly became the preeminent postwar carriers.

Following the lift of the ban, the Japanese had the opportunity to establish their own domestic airlines. Predicating this establishment was a treaty between the United States and Japan that outlined the rights afforded to each nation's carriers. The first aspect of the treaty indicated that a U.S. or Japanese carrier could increase or decrease its flights per week without limit or need for prior approval, in essence an early predecessor to current-day open skies agreements. The second aspect of the treaty intimated that, while a carrier could leave from any location in its home country, it must land at pre-designated cities in the partner country. Finally, the treaty granted U.S. carriers unlimited 'beyond rights,' which granted U.S. carriers the ability to use Japanese airspace and airports as a through point to further destinations in Asia.<sup>3</sup> For some years, this precedent of U.S. preferential rights dominated U.S.-Japanese aviation relations, adding to the protectionist tendencies built into the Japanese marketplace. Perhaps in an ironic foreshadowing, this imbalance would play out in favor of the Japanese carriers in the decades to come. This treaty, with small amendments made to it, would remain as the *de facto* legislation underlying U.S.-Japanese air travel cooperation for four decades. This treaty was set as a precedent for further negotiations even as recently as 2009, when Japanese and American representatives renewed aspects of the agreement in the U.S.-Japan Air Transport Agreement of December 14, 2009.<sup>4</sup> This treaty was only overhauled and replaced in 2010, when it replaced the current Open Skies Agreement.



## Japan in the Global Aviation Network

Japan is one of the world's largest and most central markets. It is a hub of interconnectivity for Asia and the wider world. Japan's civil aviation industry ties together this archipelagic



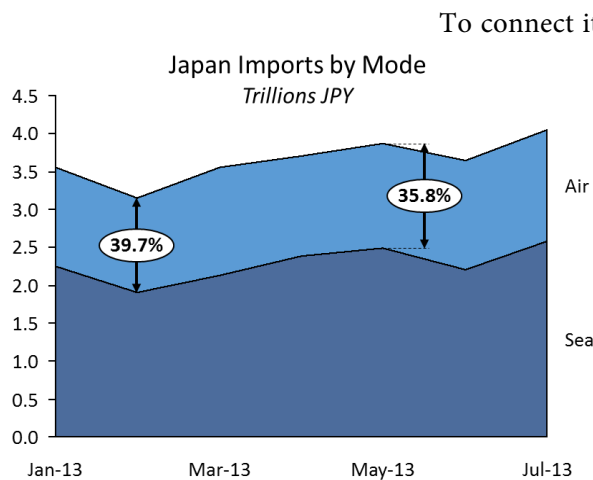
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nation. As discussed by International Air Transportation Association (IATA) CEO Tony Tyler in late 2012, “Japan is important to global air transport. And air transport is critical to Japan. Could this island nation have grown to be the world’s third largest economy without effective air links? The answer is no. In fact, there is no clearer example of the aviation industry being a catalyst for economic growth than Japan where it provides vital—irreplaceable—links to global markets. But I believe that aviation could be an even more powerful force in Japan’s economy.”<sup>5</sup> Despite its market maturity, Japan’s domestic air market is still showing growth. Compared with year over year growth, the domestic Japanese market surged nearly 6%, increasing from 4% growth in the previous month.<sup>6</sup> As a service provider for through traffic to Asia and the West as well as a facilitator of Japan as a final destination for business and leisure travel, Japan’s aviation sector continues to play an important role in the global economy.



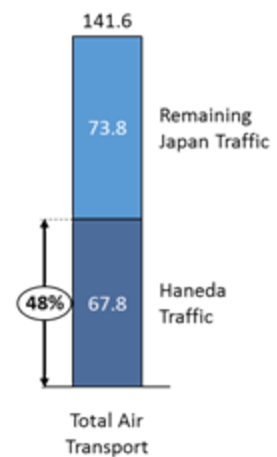
To connect its 6,800-plus islands, Japan relies heavily on airports to serve as key infrastructural centers for the movement of people and goods. As of February 2012, Japan operated 98 airports, 5 of which the Japanese government has deemed as hubs. These are Kansai International, Tokyo International (Haneda), Narita International, Chubu International, and Osaka International (Itami). The aviation industry is responsible for transporting a large portion of Japan’s trade flows. In the charts on the left, roughly 35-40% of Japanese trade flows were handled via aircraft.<sup>7</sup>

Though there is high traffic between these central airports and foreign destinations, many rural Japanese airports are suffering from flat-lined passenger traffic. Misplaced demand projections have led to critical over capacity in some airports and underuse at others. However, many of these airports were not intended to be competitive. According to a 2012 report by *The Japan Times*, many rural airports struggling to turn profits were not built on economics, but instead were “...compounded in large part by politics, with decisions made to build airports in rural, virtually no-traffic areas where turning a profit was never a realistic proposition but just a way to get voters government-backed jobs from more pork-barrel projects.”<sup>8</sup>

While traffic at regional airports has been largely nonexistent, some argue that a reassessment of airport ownership structures as well as liberalization surrounding low-cost carriers (LCCs) can help drive increased traffic.

While there are a considerable number of airports operating throughout Japan’s borders, the majority of traffic flows through its two main Tokyo hubs -- Narita International and Tokyo International, also known as Haneda. According to the 2013 IATA World Air Transport Statistics (WATS) report, Haneda ranked as the world’s fourth busiest airport by passenger traffic, handling 67.78 million passengers (7.9 million international and 59.9

Japan 2012 Air Traffic by Airport  
Millions of Passengers



domestic).<sup>9</sup> The 2013 WATS report also listed total Japanese air travel at 141.55 million passengers.<sup>10</sup> Given this rough estimation, Haneda airport served approximately 48% of Japan's total passenger air traffic. Narita International is also a critical airport for both passenger and freight services: it ranked as the world's tenth busiest airport in 2011 for cargo and mail volume. Narita handled roughly 1.95 million tons of cargo, ranking immediately behind Louisville, Kentucky (2.18 million tons), which houses Worldport, the central hub and processing facility of UPS. If you consider traffic density, it becomes clear that the Tokyo metropolitan area is the central node for Japanese air travel and commerce.

## **Haneda and Narita Airports: Roles and Operations**

In discussing the operational capacities and capabilities of Japan's aviation market, it is important to note the role that history plays in the current roles of Tokyo's two main airports. Haneda was Tokyo's first main airport. It was opened in the early 1930s, with its first runway constructed in 1939. Haneda served as the base of Japan's then-flagship carrier Japan Air Transport, and served locations in Japan, Korea, and Manchuria. In 1945, U.S. armed forces occupied Haneda Airport. It was renamed Haneda Army Air Base, where it would serve occupying forces until it was returned to Japanese control in 1952.

Following its return to Japanese control, it began service again as a commercial airport. It served in both a domestic and international capacity for numerous carriers. In 1964, in anticipation of the Tokyo Olympics, the Japanese government lifted the ban for Japanese citizens traveling abroad. In doing so, demand surged at Haneda airport, and passenger traffic reached unmanageable levels. Despite the construction of a new runway and international terminal, capacity expansion efforts still could not keep pace with demand.

Within Japan, domestic pressures built against further expansion into the 1960s and 1970s. The cost of adding additional runways, given Haneda's location on the water, was extremely high. By 1966, ground plans had been laid to create a new airport some 45 miles away. By the time Narita International Airport was completed, Haneda became a predominantly domestic airport as air traffic was diverted east to Narita.

Narita International Airport was designed to serve as an expansion to the domestic feeder network in Japan, while also enhancing Tokyo's function as an international hub. Following groundbreaking, there was incredible opposition from local residents against Narita. These demonstrators and protestors caused considerable damage to Narita (including roughly \$500,000 in damage to the aerodrome control tower before the airport's planned opening in 1978), while also leading to the eventual deaths of both protestors and police officers. When construction was finally completed, Narita International's capacity was at roughly 13 million passengers per year. Even before \$1.36 billion worth of investment in a new terminal in 1992, Narita International was handling more than 22 million passengers annually in 1991.<sup>11</sup> Haneda and Narita served as gateways to the Japanese economy—a symbol of the rapid growth of Japan's development and extraordinary economic success in the 1980s.

Despite previous cost reservations over expanding runways into Tokyo Bay, Haneda constructed an additional runway in 1988. By 2000, two additional runways were also completed. With added capacity at Haneda and a mounting passenger problem at Narita, Japanese policymakers agreed that Haneda could begin to serve international traffic once again. Some reports also indicate that Japanese citizens traveling abroad were also increasingly using foreign international hubs in lieu of Haneda and Narita.<sup>12</sup> Due to transit times between the two airports, it is easier for those outside of the Tokyo metropolitan area to use transit hubs in the Republic of Korea or China rather than fly domestically to Haneda and then transfer to Narita for an international connection. In 2003, the Japanese government allowed certain airlines to serve in a very limited international “scheduled charter” service, where JAL and ANA (along with Asiana and Korean Air) were only allocated one flight per day, which serviced Gimpo Airport in the far western end of Seoul, Korea.

Pressures from policymakers looking to advocate increased use of Narita limited the amount of traffic that Haneda could serve. This, compounded by internal pressures from local government officials in Tokyo over sound pollution from Haneda added increased challenges to the bureaucratic regulatory frameworks that needed to be adapted. To compensate both parties, officials deemed that Haneda could serve international flights that depart or arrive between 11 PM and 6 AM, when Narita is closed in deference to local demand. In their current configurations, the Japanese Ministry of Land, Infrastructure, Transport, and Tourism (MLIT) has designated Haneda as a predominantly domestic airport, providing auxiliary short-haul international service for Narita, which serves as the main international hub in Tokyo.

The two national carriers of Japan, ANA and JAL are the most dominant carriers at Narita and Haneda airports. To more completely paint the picture of current capacity and regulatory issues at Haneda airport, as well as more fully describe Haneda's opportunity to propel Japan's economic recovery and reform forward, it is necessary to understand the growth and development of both JAL and ANA. Their evolution over the years has been central to Japan's economic growth. Understanding their shared competitive history is necessary to have a comprehensive view of their relationship moving forward.

## **All Nippon Airways: Historical Overview**

Founded in December of 1952, ANA began its operating history as the Japan Helicopter & Aeroplane Transports Co., Ltd., following the abatement of the civil aviation ban and General Order No. 10. Starting with 150 million Japanese Yen (JPY) in capital (1952 JPY terms), the company had ambitiously started its own chartered and scheduled passenger service by October of 1953. In December of 1957, the company officially changed its name to All Nippon Airways (ANA). After merging with Far Eastern Airlines in March of 1958 (increasing its capital to 600 million JPY), ANA introduced a series of new airplanes.

The early 1960s were a turning point for ANA as it capitalized on widespread growth throughout the passenger aviation market. It listed on the Second Section of both the Osaka Securities Exchange and the Tokyo Stock Exchange in October of 1961, and later merged with Fujita Airlines, further increasing ANA's capital further to 4.65 billion JPY, in 1963. By 1964, ANA had introduced a number of jets and began increasing its scheduled domestic service, as JAL had the *de facto* monopoly on scheduled

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international passenger routes. By 1970, revenue passenger-miles had increased to more than 2,700, a near four-fold increase. In February 1971, ANA commenced international chartered service between Tokyo and Hong Kong for the first time in its operating history. In the mid-1970s, ANA achieved an extensive domestic Japanese network.

In 1978, ANA established Japan's first all-cargo airline as a joint venture with Nippon Yusen, a Japanese shipping company. Named Nippon Cargo Airlines, this newcomer operated an impressive fleet of Boeing 747 aircraft. As Japan's first all-cargo airline, Nippon Cargo Airlines was able to capitalize on incredible growth opportunities presented by Japan's astronomical growth.

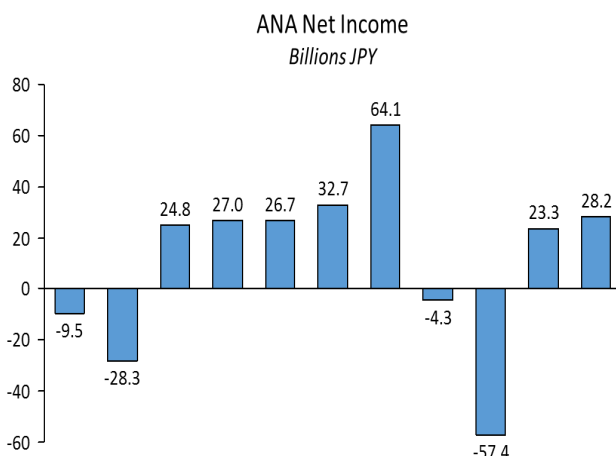
By 1985, ANA had solidified its position as a leader in domestic Japanese service. In October of that year, it served its cumulative 300 millionth domestic passenger. At that time, pressure was mounting from both the Japanese political realm as well as U.S. leaders to deregulate the Japanese international transport market. As ANA saturated its domestic market, a set of reforms were passed in 1986 that privatized JAL and allowed ANA to establish its first international scheduled service. ANA seized on demand for both inbound and outbound travel to Japan, establishing numerous international routes. It added service to Beijing, Sydney, Hong Kong, and Dalian in 1987, followed by service to Stockholm, Bangkok, Vienna, London, and Moscow in 1988. In five short years since the Japanese civil aviation industry deregulated and allowed ANA to service internationally, it was able to increase its total number of passengers served by roughly 22.5%, an incredible logistical feat.<sup>13</sup>

However, as with JAL, the 1990s were challenging for the Japanese civil aviation industry and the wider Japanese economy. Throughout the early 1990s, ANA struggled to remain profitable, and by 1994 ANA experienced its first loss in 27 years. ANA reported a \$27.9 million loss for the fiscal year ending in March 1994, as well as plans to begin restructuring and reducing its payroll.<sup>14</sup> Adding additional legitimacy and exposure to its brand equity in the global aviation market, ANA joined the Star Alliance in 1999. The mid 2000s were quite successful for ANA as traffic demand grew considerably. In 2005, after some decades of success, ANA sold its share of Nippon Cargo Airlines and established another joint venture the following year with Nippon Express (a courier and logistics company), Japan Post, and Mitsui, a Japanese trading house. The fleet for this cargo airline consisted of Boeing 767 freighters.

However, the 2008 global financial crisis was challenging for ANA's profitability margin, and passenger demand (and especially cargo demand) plummeted. While 2008 was a year of record profits, the following

crash on the air travel market from the financial crisis truly took its toll on ANA in 2010. The company suffered a 57.38 billion JPY loss (approximately \$656 million in 2010 real terms). That same year, ANA folded its cargo joint venture and absorbed the operations into the ANA network.

Since 2010, however, ANA has shown considerable resiliency. Following the economic





recession, ANA's profitability has nearly rebounded to its mid-2000s level. In its FY2012 Annual Report, operating income increased 43.1% year over year to a record-high 97.0 billion JPY. According to its Q3 2012 results, ANA forecasts that its FY2013 net income will grow some 42% year over year.<sup>15</sup> Despite these positive projections, ANA announced a net 6.6 billion JPY loss for Q1 on July 30, 2013. Rising fuel costs as well as a weakening yen contributed to this loss, as well as the temporary grounding of ANA's Boeing 787 "Dreamliner" crafts. On September 13, 2013, ANA announced its intended order of some 25 jets. ANA's CEO Shinichiro Ito indicated that the order would be made for either Airbus A350 or Boeing 777X (still in production).<sup>16</sup> ANA has made clear its intentions to become the lead domestic provider of air services to the Japanese market. It has pushed hard publicly to deliver a message that corporate restructuring for JAL was unfair, and ANA should be compensated by receiving more capacity at Haneda airport to offset past government support to JAL.

## Japan Airlines: Historical Overview

Founded in 1951, Japan Airlines is the oldest Japanese airline still in service. It was founded on August 1 with 100 million JPY in capital as Japan Air Lines. It opened its headquarters at Haneda Airport, which had been used previously as a U.S. army air base during U.S. occupation. Shortly thereafter, JAL opened satellite offices in Fukuoka and Sapporo. Before the official ban on Japanese civil aviation was lifted, JAL entered into an agreement with American carrier Northwest Airlines in November 1951. Northwest provided JAL with a suite of flight operations, because of restrictions still in place grounding Japanese aircraft. By the time the ban was lifted in 1952, Japan Air Lines began training its own set of pilots, navigators, and flight attendants. On August 1, 1953, under the Japan Air Lines Company Act put forward by the Japanese Diet, Japan Airlines formed as a national flag carrier for Japan out of the formerly private Japan Air Lines. At this point, the government of Japan owned roughly a 60% stake in JAL.<sup>17</sup>

By the beginning of 1955, JAL had offices across the United States, including Chicago, San Francisco, Los Angeles, and New York, and was operating intra-Asian flights between Tokyo and Hong Kong. In 1972, the Japanese Ministry of Transport fully enacted JAL as the international flagship carrier of Japan by giving it sole operational rights on international flights as well as major trunk routes in the Japanese domestic market. This allocation of routes evolved from the "70/72 Scheme," which was named after a cabinet-level meeting in 1970 entitled "Approval on Management Regimes of Airline Companies" and a commensurate response in 1972 from the Ministry of Transport (later to be assimilated into the Ministry of Land, Infrastructure, Transport, and Tourism). This framework essentially predetermined the business spheres of leading Japanese airlines.<sup>18</sup> The 70/72 Scheme became the policy rationale for a total lack of competition on numerous Japanese flight routes. JAL and ANA were granted sole operating rights for certain routes. By 1978, JAL had reached a total of 100 million domestic and international passengers since the foundation of the company. The flagship carrier had established itself as the representative airline of Japan.

In October 1985, the Aviation Policy Extraordinary Committee of the ruling LDP announced a report that recommended full privatization for JAL while encouraging it to retain its position as the official national flag carrier of Japan. By 1987, Japan Airlines had completely privatized, with the Japanese government

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selling its 35% share in the company. At this point, ANA was allowed to engage in unregulated competition with JAL on both domestic and international routes. Increased competitive pressure on JAL led to a corporate restructuring, dividing domestic and international passenger service as well as founding a cargo service within JAL.<sup>19</sup> The economic malaise in Japan of the 1990s hit JAL hard, and it posted either considerable operating losses or at best tepid growth throughout the decade.

In 2001, JAL received its first government assistance package, followed by a 2002 merger with Japan Air Systems. In 2007, JAL joined the Oneworld alliance. JAL was hit hard following the economic recession of 2008 and 2009. Despite accepting further government aid, it suffered nearly \$1.4 billion in losses from March to September 2009.<sup>20</sup> At the point of announcing its bankruptcy, JAL held nearly \$25 billion in debt, requiring significant restructuring.<sup>21</sup>

The JAL bankruptcy proceedings were arduous, a humbling experience for this historic pillar of Japanese aviation and commerce. JAL entered into a court-supervised restructuring, and received considerable government support under the Corporate Rehabilitation Law. Amid the controversy over the bankruptcy proceedings, JAL's CEO Haruka Nishimatsu resigned. Kazuo Inamori, former CEO of Kyocera and noted for his ability to turn around ailing firms, was tapped as Nishimatsu's successor.

Around the time of its announced bankruptcy, JAL was courted by a number of American carriers looking to entice the ailing Japanese carrier out of the Oneworld alliance. In an attempt to lure JAL to the SkyTeam Alliance, the only major global airline alliance without a Japanese partner, Delta Airlines offered JAL a financial assistance package worth \$1 billion to leave Oneworld.<sup>22</sup> American Airlines, a representative of the Oneworld alliance, raised its own package from \$1.1 billion to \$1.4 billion as a counteroffer to Delta's proposal.

Beyond government-sponsored restructuring, JAL removed a large number of its unprofitable routes serving domestic and international locations. In fact, JAL removed 50 domestic routes, nearly all of which were incredibly unprofitable for the company. JAL shut down 28 international routes that were unprofitable or not flying at capacity. Beyond its route reorganization, it also closed 11 international bases and 8 offices. JAL was also able to remove nearly a third of its bloated workforce, saving the company some 81.7 billion JPY annually in labor costs.<sup>23</sup> In addition, JAL made tough cuts on employee pension schemes, which had weighed heavily on operating costs. JAL received 600 billion JPY from the Japanese government under the bankruptcy-restructuring program. The Enterprise Turnaround Initiative of Japan (ETIC) provided 350 billion JPY, while the remaining capital was acquired as bridge loans from the Development Bank of Japan. JAL was able to reimburse its debts in full following its relisting on the Tokyo Stock Exchange on September 19, 2012.<sup>24</sup>

In an unprecedented economic turnaround, JAL has returned to profitability. According to its 2013 Annual Report, total operating profit margin remained extremely high, at 15.8%, while operating revenues for FY 2012 increased by 2.8% from the previous year. JAL reduced its operating costs from a staggering 2 trillion JPY to 1 trillion JPY from FY2008 to FY2011. Moreover, while operating profit declined from 204.9 billion JPY to 195.2 billion JPY from FY2011 to FY2012, JAL reports that this loss is due to increased operating expenses stemming from increased fuel prices and a weakening yen. In recent

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decades, JAL faced an uncertain future and considerable profit loss, but given its current profitability and performance, JAL is back on even footing.<sup>25</sup>

## REGULATORY CHALLENGES

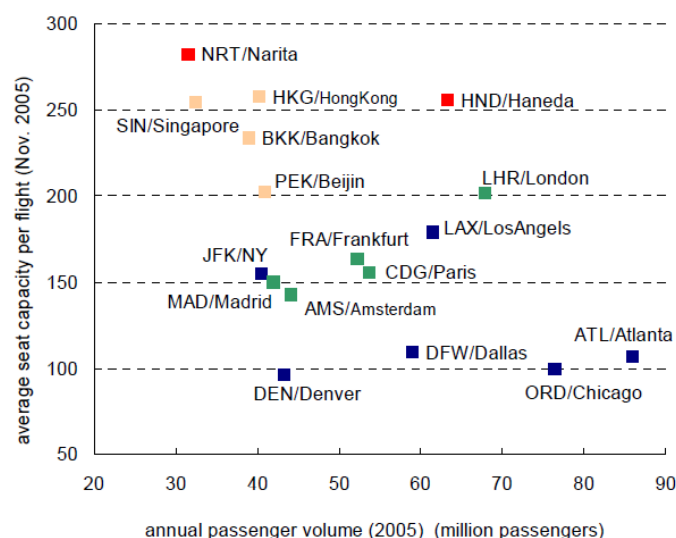
Aviation has a long history in the Japanese economy. It constitutes a significant portion of total productivity and creates hundreds of thousands of jobs for the Japanese people. Yet there are acute issues nascent in the industry that hamper competition and prevent effective regulatory operations. Japanese civil aviation has long suffered from chronic under capacity in Tokyo and over capacity in rural airports. Stemming from critical miscalculations and political favors, these factors have caused a series of failing rural airports and a hostile politically charged regulatory environment in Tokyo. Furthermore, this has hindered the development and success of low-cost carriers (LCCs) in Japan. While capacity issues are easily solved, special interests are heavily entrenched, hanging on to a skewed system of favoritism and political influence. These factors have coalesced into a matrix of uncompetitive and rigid regulations.

### The Present Day: Increasing Haneda Capacity

In May 2008, the Japanese Ministry of Land, Infrastructure, Transport, and Tourism (MLIT) made an announcement to the airline community. Scheduled passenger international traffic would be allowed at Haneda once again (though it would serve in the above limited time capacity). To increase capacity in a limited fashion, MLIT officials solicited requests for specific landing slot allocations. These allocations directly correlate to revenue for an airline- each allocation represents the opportunity to conduct one flight.

The allocation of landing slots is in essence a very technical process. The International Air Transport Association (IATA) has created a comprehensive guideline to ensure fair and equitable distributions, based on industry best practices. As outlined in full by IATA, "... [this] process governs the allocation and exchange of slots at congested airports worldwide, on a fair, transparent and non-discriminatory basis... The prime objective of the slot process is to allow airlines to acquire, retain and exchange slots necessary to operate at a given airport. Through the allocation of slots, limited airport resources are efficiently used to benefit the greatest number of airport users and travelers."<sup>26</sup> If implemented as outlined, slot allocations can ensure a level playing field and transparent regulatory framework while ensuring the most efficient use of available capacity.

In recent years, tensions over the limited landing slots and unfair regulatory practices at Haneda have dominated discussions in Japan because of critical capacity challenges at Tokyo's central airport. In the adjacent chart from Hirata and Morichi's "Comparative Analysis of Domestic Flight Frequency between Japan and U.S. Aviation Market" shows that capacity constraints at





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Haneda have reached such heights that carriers must resort to the largest aircraft in their fleets to maximize passenger transportation.<sup>27</sup> Haneda and Narita rank among the highest airports for seat capacity to annual passenger volume ratio.<sup>28</sup> However, with inadequate capacity and an opaque allocation process for landing slots, leading airlines resort to redress through public forums or, in some cases, private communiqué with bureaucratic officials. In a study on Northeast Asian airport efficiency, Hun-Koo Ha explains the situation in Tokyo as such:

That airline liberalization, both domestically and internationally, has come relatively slowly to Japan may have to do with the capacity constraint at its major airports, particularly landing slots at Tokyo Haneda, Tokyo Narita, and Osaka (Itami). In the past Japan's Council for Transport Policy argued that because of airport capacity constraints, an American style of deregulation did not suit the circumstances of Japan. While the overall national capacity has increased in parallel with the deregulation, slot shortage at congested airports has not been resolved. Yamauchi points out that slot shortage has been the single most important barrier to expanding air services to and from Japan for a long time.<sup>29</sup>

In some instances, these tensions were aired in the media, where industry leaders levied their frustrations. Initial indications were that Japanese bureaucratic decision-making would be more or less consistent with IATA best practices, reflecting industry needs and carrier capacity. Yet as the domestic slot allocations were announced for Haneda, it appeared that allocations were not following this designated system. As limited expansions at Haneda have increased, so too has the media spotlight on allocation proceeding, which have revealed troubling trends. Press coverage and academic research of the airport has illuminated a systemic series of uncompetitive tactics and regulatory barriers that hamper fair competition in the Japanese civil aviation market.

## **CURRENT REGULATORY ENVIRONMENT AND COMPETITIVE LANDSCAPE**

Announcements came in late 2012 that MLIT had decided on domestic Haneda landing slot allocations. Following the restructuring and government support for JAL, ANA lodged considerable complaints with the Japanese government centered on the argument that support provided to JAL granted an unfair competitive advantage. MLIT, under the ruling party at the time the DPJ, released a document entitled “Ways to Deal with Rehabilitation of JAL” in August of 2012. MLIT stated that it would exercise oversight on JAL to ensure a competitive environment, and make adjustments on JAL as appropriate. That November, an announcement was made that of the 11 open domestic slots for domestic carriers at Haneda Airport; ANA received eight to JAL’s three.

Historically since the “re-internationalization” of Haneda, JAL and ANA had received equal slot allocations for international flights. As part of its policy goal of increasing capacity at Haneda, MLIT also announced that it would expand international access by providing additional landing slots during the winter schedule of 2013.<sup>30</sup> Beginning in the end of March 2014, Haneda capacity would increase to accommodate roughly 40 additional international flights per day. Of the 40 new daily landing slots for

international flights, MLIT noted that that it would allot 20 for domestic airlines, while the rest were designated for foreign carriers.

While the precedent existed for even allocations of international slots, senior executives vocalized their discontent through media outlets. On May 25, 2013, ANA CEO Ito conducted an interview for *Toyo Keizai* where he was quoted saying “we are asking for remedial action on the current unfair competitive environment (between JAL and ANA). To be frank, ANA should be allotted more slots (than JAL from among Haneda’s new international slots). We want them all.” Two months later in July, 2013, Ito remarked again on Haneda international slots. “I have nothing against JAL and it put a lot of effort into turning itself around, but the way it was saved was not right... the Haneda slot distribution can go some way to fixing the skewed competitive environment.”<sup>31</sup>

On the side of the regulatory authorities, reports indicate that many within the Ministry of Land, Infrastructure, Transport and Tourism desire fair and transparent allocations. A 2010 capacity analysis report from MLIT wrote on the allocation proceedings. “The JCAB thinks it appropriate that the slot swap or slot exchange between domestic and international flights should be encouraged at Haneda Airport. The JCAB (Japan Civil Aviation Bureau), thus, strongly believes that Haneda Airport should be categorized as level 3 airport by IATA and the schedule coordination services should be conducted by NRT/KIX schedule coordination on [a] neutral, nondiscriminatory and transparent basis according to IATA world slot guidelines.”<sup>32</sup> However, with unexpected uneven domestic slot allocations following considerable pressure and politicization of this issue by industry leaders, it is unclear how the allocation decision will unfold for international slots.

Reports of industry politicization are probable. With such little capacity, Japanese carriers must fight tooth and nail to seize as many revenue opportunities as possible. Current international slot allocation expansions are worth an estimated \$400 million.<sup>33</sup> JAL and ANA are waging an incredibly intense battle. JAL’s restructuring has been successful, and propelled the former flagship carrier to profitability and rebirth. ANA has shown considerable economic resiliency through the economic recession, confident it can step forward as the dominant carrier of Japan. What is not to be expected, however, is the effect which industry politicization appears to have on regulators and allocation proceedings. In examining this issue, regulatory inefficacy has certainly contributed to such animosity between these two carriers. However, the structural competition and regulatory inefficacies that exist between JAL and ANA in international landing slots at Haneda go far beyond domestic economics.

## Japan-U.S. Bilateral Engagement

There are numerous foreign carriers, particularly in the United States, who are monitoring current allocation deliberations with interest. American carriers play a large role in the Japanese civil aviation sector. From July 29 to August 4 of this year, American carriers represented 21.3% of total flights at Narita International. Japan held 37.7% of flights. South Korean flights represented only 8.7%. While international landing slots for foreign carriers are separate from domestic carriers, the allocation decisions have lasting consequences for the international aviation market. Within the Tokyo metropolitan area, Star

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Alliance has the largest share of international slots, with roughly 40% of Haneda and 39% of Narita. Oneworld holds a 31% and 26% percent stake in Haneda and Narita respectively, while SkyTeam Alliance constitutes roughly 17% and 24%. Many American carriers have consistently fought hard for access rights to Haneda. By dint of its strategic geographic location, Haneda has the opportunity to facilitate a considerable amount of business travel, as well as tourism.

### **U.S.-JAPAN OPEN SKIES**

Following some years of negotiation, the United States and Japan signed an Open Skies Agreement in October of 2010. The agreement was signed by then-U.S. Ambassador to Japan John Roos and MLIT Minister Sumio Mabuchi. This was the first major overhaul of the original 1952 aviation treaty between the two countries in more than two decades.

Despite the promising developments that took place under the Open Skies Agreement, there has yet to be a major redress of U.S. concerns surrounding its terms. U.S. airlines continue to push for daytime rights at Haneda, which remain limited by the 11 PM to 6 AM Narita curfew; international daytime slots at Haneda are only allowed for short-haul flights to Asian destinations. Without allowing for daytime access rights, Haneda was functionally limited for many American carriers. Without daytime rights, flights leaving U.S. hubs such as Dallas Fort Worth would otherwise have to leave at extremely late hours to arrive in the designated time window for Haneda. Many American carriers have advocated for transferable rights of landing slots to Haneda from Narita in order to take advantage of its location and proximity to Tokyo.

### **YOKOTA AIR BASE<sup>34</sup>**

Following the Japanese surrender, the United States took control of numerous military installations across Japan. As discussed above, Haneda airport was first a military field and later claimed by the U.S. Army for use until 1952. In Western Tokyo, Japanese imperial forces established an air base named Tama airfield in 1940. It served as a test center for the Imperial Japanese Army Air Service. After U.S. forces claimed the airbase, it has undergone several decades of active use, including operations throughout the Korean War. In 2006, the Japanese Air Self-Defense Forces co-located their base of operations to Yokota.

In its current capacity, Yokota serves as a base of cooperation between the Japanese Self-Defense Forces (JSDF) and U.S. Military forces. It is actively involved in the forward deployment of U.S. military assets in the region. Drawing from our previous study, Yokota Air Base is a vital strategic asset for the U.S.-Japan alliance and would play crucial roles in combat, combat support and strategic lift in the defense of Japan. Japan would be a central staging base for combat, command and control, and strategic transport operations in the event of a future crisis in Korea, continuing the precedent set during the Korean and Vietnam Wars.

Yokota serves as an example of the deep ties shared in the U.S.-Japan alliance. In the current climate of Japanese aviation, however, Yokota could potentially serve in a capacity beyond its current military use.

As early as 2003, there were discussions between Prime Minister Junichiro Koizumi and President George W. Bush over potential cooperative civil aviation use for the Yokota air base. Current capacity challenges at Tokyo's main airports, particularly Haneda, now makes dual use even more feasible. This proposal has enjoyed considerable bilateral support, with members of the U.S. military as well as the Tokyo Metropolitan Government advocating for its dual military and civilian use.<sup>35</sup>

There are some marked challenges involved. Dual use could help improve civilian air traffic management and capacity expansion. However, as a requirement of dual use with the military base, any efforts to develop its civilian capabilities must also work to increase military capacity (both at Yokota as well as possibly increased contingency access to other air fields). Military protocol also procures a long list of technical and logistical requirements for Yokota to operate in a civilian capacity, including continued U.S. operational control, retained military priority, and a relatively high degree of combat readiness.

As the U.S. continues its strategic rebalance to the Asia-Pacific region and the current LDP administration seeks to deepen its bilateral engagement with the U.S., civil operations could help advance a more robust role at Yokota while also cultivating shared commercial ties through civil aviation.

## In Review

In its current state, the regulatory frameworks surrounding the Japanese aviation industry are opaque, uncompetitive, and in need of redress. Haneda has the opportunity to draw incredible amounts of revenue, both from its use by domestic Japanese carriers and foreign American carriers. While there is considerable contention surrounding slot allocations as well as the general endemic protectionism and favoritism that exist in the Japanese market, the airline industry in Japan remains a strong potential catalyst for economic growth. Reform efforts from Prime Minister Abe and the LDP are coinciding with the culmination of frustrations of many Japanese civil aviation stakeholders. As part of his Third Arrow, Shinzo Abe wants to demonstrate his commitment to 21<sup>st</sup> century business practices, facilitating reform and attracting both FDI and tourism to Japan. This is a positive-sum game. Both JAL and ANA, along with American carriers and stakeholders, stand to gain from a reformed and deregulated airline industry. If handled correctly, Prime Minister Abe and his team can push Tokyo and wider Japan into the 21<sup>st</sup> century of aviation and in doing so project a Japanese investment climate that is 'open for business.'



## **CIVIL AVIATION AND THE JAPANESE ECONOMY: CLEARED FOR TAKEOFF**

With appropriate policymaking, an advantageously located airport can attract a remarkable amount of investment. Japan's role and reliance on global aviation is seminal. At the center of that aviation system is Haneda, which is responsible for roughly 60% of Japan's passenger traffic. Haneda plays a critical role in the local Tokyo economy, employing roughly 87,000 people directly in 2012, with indirect, induced, and catalytic employment estimated at over 190,000.<sup>36</sup> While employment at Narita International has dropped nearly 20% since 2009 due to the global economic downturn, the airport still hires roughly 40,000 people.<sup>37</sup>

Japanese aviation is a key economic driver in Japan by facilitating tourism and foreign direct investment. With the announcement of Japan as the host of the 2020 Olympic Games in September 2013, the opportunities for increased tourism and investment are even higher, as are the stakes for failed reform efforts.

### **Tourism**

Japanese tourism constitutes a very large portion of incoming investment. In 2012, the Japan National tourism Organization in conjunction with the Japanese Ministry of Justice recorded that 8.36 million foreign visitors entered Japan, 6.04 million of which were tourists.<sup>38</sup> The combined economic benefits of aviation and its contribution to tourism totaled roughly 1% of Japanese GDP and 1% of the Japanese workforce (around 620,000 jobs).<sup>39</sup> Moreover, Japan hosts 16 UNESCO World Heritage Sites, many of which are situated in the historic city of Kyoto. Tokyo is also a popular destination for tourism, including Mount Fuji. Many of Japan's cities rely heavily on this influx of foreign and domestic visitors.

In its quarterly report on Japanese tourism, Business Monitor International commented on the general state and health of the industry, including historical traffic levels. "The number of air and sea tourist arrivals continually increased between 2001 and 2007. Tourist arrivals by air were by far the most predominant, with 8.49 million arriving by air in 2007, compared to 666 thousand by sea. Leisure arrivals outnumber those visiting Japan for business purposes."<sup>40</sup>

South Korea, Taiwan, China, and the United States constitute the largest portion of foreign tourists to Japan. Northeast Asian tourism dominates, with South Korean tourism contributing over 2.04 million visitors in 2012. Visitors from Taiwan and China both totaled at 1.46 and 1.42 million, respectively.<sup>41</sup> U.S. tourists numbered .72 million, by and away the largest non-Asian tourist segment in the world.<sup>42</sup>

JAL and ANA have a considerable stake in tourism. Both have low-fare programs to attract foreigners to experience Japan. When traveling on JAL and departing Japan on a Oneworld carrier, JAL offers a special fare-reduction program called "Oneworld Yokoso". JAL also offers a secondary program called "Welcome to Japan". Both programs offer incredibly reduced fares for foreign visitors flying within Japan- the Oneworld Yokoso program allows foreigners to purchase one-way tickets for over 30 cities for 10,500 JPY (\$105). ANA also offers similar programs. The 'Experience JAPAN' program, launched in August 2012,

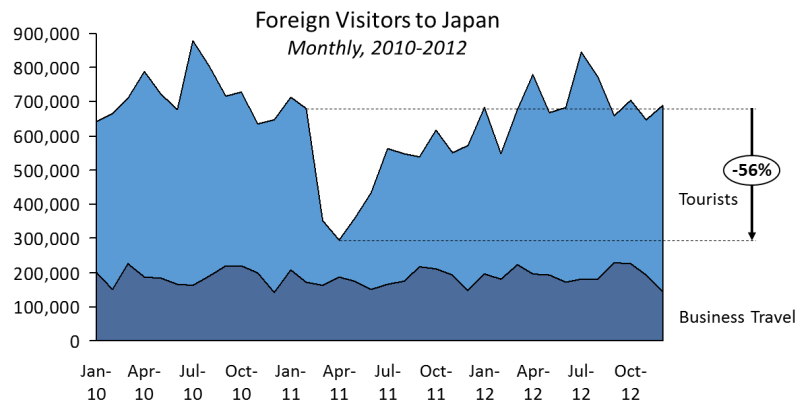
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offers competitive low pricing to JAL's programs, offering a wide number of city destinations for 10,500 JPY. Many destinations offered by these programs are key destinations for foreign and domestic tourists, including Okinawa, Ishigaki, Sapporo, and Fukuoka.

## THE TOHOKU DISASTER

In March of 2011, a massive series of earthquakes, peaking at a magnitude 9.0, struck off the coast of Japan. It was the largest earthquake in Japanese history and the fifth most powerful earthquake in recorded seismological history according to the U.S. Geological Survey. This earthquake was responsible for a massive tsunami, which crashed into the Eastern coastline of Honshu in a region as Tohoku. This disaster would later be responsible for an estimated 20,000 deaths and anywhere from \$200-300 billion in property and infrastructure damage.<sup>43</sup> Resulting from this disastrous event was the Fukushima nuclear disaster. This nuclear meltdown, following loss of power at the Fukushima Daiichi Reactor, has led to a devastating ecological tragedy. Initial reports indicated that the situation was under control. Two years after the disaster, the Tokyo Electric Power Company resigned from the cleanup effort in place of the Japanese government as news broke that highly radioactive water had been leaking into the Pacific Ocean following persistent denial from TEPCO.<sup>44</sup>

The Tohoku disaster hit Japanese tourism hard. In the aftermath of the March 2011 earthquake and tsunami, many airlines reduced or cancelled flights to and from Japan due to a sharp reduction in demand. JAL reduced flights from Tokyo Narita airport to Hawaii, China and Korea.<sup>45</sup> As depicted in the chart at right compiled with data compiled from the Japan National Tourism Organization, foreign tourism dropped 56% in the months following the disaster. While tourism levels have more or less returned to the levels pre-disaster, many foreign tourists' views of Japan are stigmatized by the disaster. With reports circulating that radioactive waste from Fukushima Daiichi is far from contained, the situation remains fresh for many across the world.<sup>46</sup>



Both ANA and JAL have invested to support the reconstruction efforts in place in Tohoku. JAL has created its "Visit Tohoku!" project, which encourages consumption and promotion of Tohoku products to bring economic stimulus back to the local community. JAL also created a donation fund, providing children and families affected by the Tohoku earthquake with vacation packages to Okinawa. ANA has created a flight program to provide free transportation of relief workers as well as vital supplies to the Tohoku region at request of the Japanese government. ANA also established a Star Alliance dividend

miles program where mile holders can donate their accrued miles to individuals affected or displaced by the Tohoku disaster. While support for reconstruction efforts in Tohoku is expected of Japan's most influential and powerful corporations, JAL and ANA's specific programs reflect the vested interest both share in rebuilding the local economy and increasing air traffic and tourism to the region once again.

As described in full below, Prime Minister Abe has identified tourism as a main sector to stimulate through his Third Arrow reform efforts. With air travel so intrinsically tied to the operations and vitality of the Japanese tourism industry, Abe's reform efforts offer considerable opportunities to stimulate Japanese tourism through addressing reforms in the rigid Japanese aviation sector.

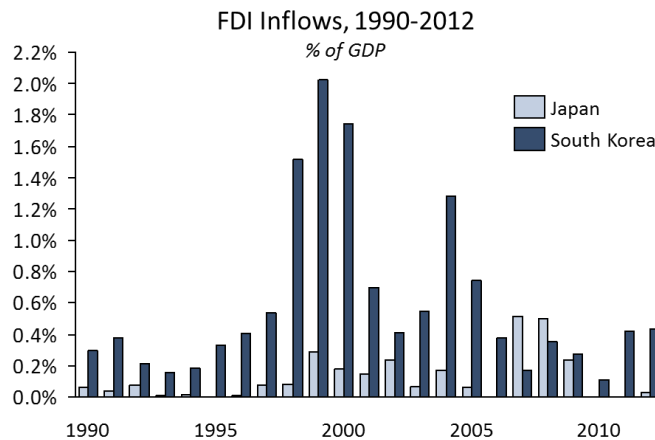
### **2020 OLYMPIC GAMES**

On September 7, the International Olympic Committee announced that Tokyo would host the 2020 Olympic Games. The decision came over a year after Istanbul, Madrid, and Tokyo submitted bids in July 2012. Following this announcement, the Nikkei Index soared 2.5% in a day, building on already impressive gains for the year. Market confidence has risen considerably since Abe's election. The Japanese government estimates that hosting the games will draw up to 8.5 million tourists to the Tokyo metropolitan region, over twice its annual visitors in a short 28-day period.<sup>47</sup> When factoring in Olympics-related investment and spending, hosting of the games will inject roughly 3 trillion JPY (\$30 billion) into the Japanese economy, with one report from NBC World News estimating as high as \$40.4 billion.<sup>48</sup>

The Olympic Games are the boon that Abe and his team have been hoping for to spark investment and drive the domestic economy. One report from CNN Money intimates this victory for the Japanese government quite accurately. "Winning the Olympics is in itself no guarantee of long-term economic gain -- plenty of host cities have ended up paying a heavy price -- but analysts believe Tokyo's victory could give Abe the confidence to press ahead with the third pillar of his strategy, namely structural reforms the Japanese economy desperately needs."<sup>49</sup>

The airport capacity necessary to handle 8 million tourists within the span of 28 days is considerable. Shortly after the Olympics news broke, MLIT announced plans to expand landing slots at Haneda and Narita to handle this influx beyond original slot increases in 2013 and 2014.<sup>50</sup> The expansion of slot allocations is a positive step at both airports, particularly Haneda. Japanese bureaucrats must work efficiently and precisely to ensure that allocated slots maximize market coverage. However, given precedent of current negotiations, these slot expansions have the potential to become politically charged. There is considerable international attention surrounding these allocations, particularly their implications for aviation's competitive landscape. By ensuring transparent and equitable allocations, Prime Minister Abe can reaffirm his administration's commitment to reform and the Third Arrow.

## FOREIGN DIRECT INVESTMENT



Identified by Prime Minister Abe a main target for Third Arrow reforms, foreign direct investment (FDI) could further push the Japanese economy forward in the 21<sup>st</sup> century. Yet despite the policy aspirations of the current administration, Japan has historically ranked low when it comes to openness to FDI. In Swiss Business School IMD's 2012 World Competitiveness report, Japan ranked 47<sup>th</sup> out of 59 in receptiveness to FDI, below both Kazakhstan and Colombia.<sup>51</sup> In the chart on the left, Japan's FDI inflow as % of GDP is compared against South Korea.<sup>52</sup> Even compared to a country of similar

technological, social, geographic, and economic development, Japanese FDI inflows are markedly behind South Korea's. The United Nations ranked Japan 132<sup>nd</sup> of 182 economies in a scale of FDI attractiveness. Analyses indicate the situation is worsening—in 1999, Japan ranked 95<sup>th</sup>.<sup>53</sup> As noted by the Abe administration, attracting FDI has the ability to cultivate economic growth and prosperity by providing innovation and job business investment to local communities and Japanese firms. In speaking towards his facilitated support and negotiations, Chair of the American Chamber of Commerce in Japan Ken Lebrun said, "...over the last five years, 90 percent of my work has been outbound deals [leaving Japan]."<sup>54</sup> Japan has ranked the most closed economy on the OECD's index of regulatory restrictions to FDI. These include foreign equity holdings, screening and approval procedures, rules on hiring foreigners, and laws on capital retention.<sup>55</sup>

Similarly to tourism, FDI is closely linked with the civil aviation sector, specifically in the U.S.-Japanese bilateral relationship. InterVISTAS, an aviation and transportation consulting group, compiled a comprehensive analytical report in 2005 entitled "The Economic Impact of Air Service Liberalization". The report cited numerous studies, including one primary research study which established a causal link between Japanese FDI into the U.S. based upon the amount of air service provided. This study examined FDI outflows at a state-level. An excerpt from the InterVISTAS report is as follows:

Hansen and Gerstein (1991) investigated the relationship between Japanese air service to the United States and Japanese direct investment in the United States. Using data from 1982 to 1987, the analysis related the amount of Japanese investment in each U.S. state to measures of level of air service operated between Japan and that state (and other background factors). The analysis found a significant positive relationship between investment and air service. The results also suggested that the amount of service provided by Japanese carriers had a larger impact on investment than service provided by U.S. carriers. The issue of causality is also addressed (i.e.,



does more air service lead to greater investment or does greater investment lead to more air service), with the authors concluding that the evidence indicates that air service impacts on investment rather than the other way around. The authors concluded that better air service supports the input needs (i.e., labor and materials) of the Japanese ventures in the U.S. and enables greater awareness and information flows in Japan for U.S. regions.<sup>56</sup>

Heuristically, this relationship is applicable in a Japan-centric model: increased air service by Japanese carriers is correlatory with increased investment. The research correlated (with a degree of causality) that increasing air service liberalizes value chains, encouraging a greater influx of both human and physical capital. In this model, a government can facilitate greater investment through increasing both the frequency and capacity of air transportation to a region.

There have been numerous studies beyond Hansen and Gerstein that have examined the relationship between aviation reform and business investment. As cited by InterVISTAS and authored by Adrian Cooper and Phil Smith of EUROCONTROL, “The Economic Catalytic Effects of Air Transport in Europe” establishes a strong causal link between air transportation usage and business investment. The report found that a general 10% increase in air transport use will increase business investment by 1.6% over a 5 year period.<sup>57</sup> Significant for this study, as well, was that *catalytic* economic growth increased over this period, as opposed to direct, indirect, or induced. These measures reflect employment and activity supported by the aviation sector or aviation supply chain as well as employment caused by consumers employed in the aviation sector. Catalytic economic growth instead measures trade, tourism, and investment caused by the air transport’s connectivity. Based on these findings, increasing air capacity and encouraging traffic can directly stimulate trade and investment both within and more importantly outside the aviation sector.

There is a strong relationship between civil aviation and FDI and tourism. It is an intrinsic aspect of attracting increased investment, especially in the island nation of Japan. Based on this historical evidence, liberalization of the Japanese civil aviation sector could serve as a critical pillar to advance PM Abe’s reform efforts and stimulate FDI and tourism growth. There are structural challenges within both the FDI and tourism sectors in Japan which stem from overregulation, protectionism, and misplaced government support. By reevaluating its policies and ensuring a competitive and liberalized air transportation market, the Japanese government can encourage growth in its targeted industries that are linked to aviation while working in parallel to ensure an open regulatory environment for investment.

## RECOMMENDATIONS: PRIME MINISTER ABE'S THREE ARROWS AGENDA

Japan is currently undergoing its most significant set of political developments in more than twenty years. In 2009, following decades of economic malaise and stagnation, the Japanese people ousted the ruling LDP party in favor of the DPJ.

The LDP has historically been the party of power in Japan, having previously lost only one general election (1993) since its organization in 1955. The LDP's loss was historic in Japanese political history. The Japanese people were dissatisfied with the state of political affairs. Some analysts argue that the DPJ's platform of change and rebirth won the 2009 election. While this may have contributed to the power shift, the LDP's own political cronyism and party mismanagement also contributed to the political upheaval. On causes of the LDP's first defeat in 16 years, the *Japan Post* writes that "...eventually, public frustration and distrust spread over the LDP's frequent money scandals, apparent favoritism toward vested interests and rotation of prime ministers picked in lieu of general elections, including Abe and Aso, [went unaddressed] until voters finally sent the party packing in 2009 and brought in the DPJ."<sup>58</sup> The DPJ ran on a platform of a crackdown on political cronyism and corruption, educational and healthcare reform, as well as a reduction of the corporate tax rate for small and medium enterprises.<sup>59</sup>

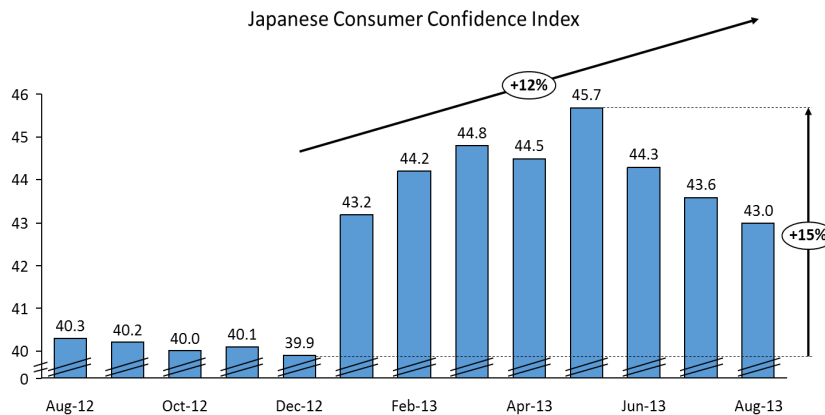
There were high hopes for the DPJ. The first major opposition party victory in nearly five decades, many considered the election as a major turning point in Japanese political history. Yet despite these aspirations, DPJ rule was short-lived. The DPJ was not able to solidify its power base, and in the 2010 upper house election lost seven seats to the LDP. Without control of the upper house, the DPJ was unable to address the major policy issues it campaigned upon, and lost the support of its constituents.<sup>60</sup> The DPJ's election to power provided a strong exogenous shock to the LDP. During this period, the LDP looked inward at many of its policies and rearranged its power base. By 2012, the LDP was able to reshuffle its internal factions and resurface with greater unity and cohesion.

In the 2012 general elections, the LDP was voted to its former status as ruling party with its coalition partner New Komeito. The LDP took 294 seats and 43% of the popular vote. Its president, Shinzo Abe, was nominated and then voted in for his second term as Prime Minister, having first served from 2006 to 2007. Soon after his election, Abe made the following announcement at a news conference in Tokyo: "With the strength of my entire cabinet, I will implement bold monetary policy, flexible fiscal policy and a growth strategy that encourages private investment, and with these three policy pillars, achieve results."<sup>61</sup> This proposal would come to be the framework for Abe's Three Arrows—his administration's policy agenda to revitalize Japan from decades of economic woes and stagnation while delivering substantial reform.

Shortly after his election, Abe delivered his First Arrow—a bold inflationary monetary policy. He appointed Haruhiko Kuroda as the Governor of the Bank of Japan to advance this policy initiative. Working with Kuroda and his policy team, Abe set about orders to increase inflation by 2% in order to shock the domestic market out of its deflationary position. Kuroda doubled the monetary base of the JPY, and the market have responded positively. The value of the yen has fallen from its high of 77 JPY to the

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dollar. As of September 2013, estimates indicate that the First Arrow adjusted the exchange rate to around



100 JPY to \$1. The Nikkei has risen considerably since Abe took office. Consumer confidence has also increased, as demonstrated at right. While dropping from its May 2013 high of 45.7, consumer confidence has risen 12% since Shinzo Abe took office.<sup>62</sup> The weaker yen has made Japanese exports more competitive abroad. In fact, the value of Japanese exports reached a three-year high in August 2013, with a 12.2% year

over year growth in July 2013.<sup>63</sup> These policies seem to have enacted a positive step towards economic revitalization.<sup>64</sup>

Prime Minister Abe's Second Arrow came shortly after his election. To supplement his fiscal policies, Abe announced what he deemed a "flexible" fiscal policy to simulate further growth. Since taking office, the LDP leader has revealed an ambitious investment plan of 200 trillion JPY (\$2.02 trillion) to stimulate the Japanese economy over the next ten years.<sup>65</sup> Financial analysts from Citi Bank in Tokyo believe that spending will be dominated by "shovel-ready" projects focusing on infrastructure revitalization, such as tunnel repairs and earthquake preparation on vital public works.<sup>66</sup> This spending plan is quite ambitious—the Japanese government estimates that this stimulus could stimulate 2% growth and create as many as 600,000 jobs.<sup>67</sup> While Abe's office has yet to release specifics on this plan, the administration is keen on delivering with these policies. Coupled with the ambitious monetary policies of the First Arrow, the Prime Minister has delivered a shot to the arm for the Japanese economy.

## The Third Arrow's Reform Prospects

Japan's best chance for real long-term growth, however, is the Third Arrow. By all accounts, this is the most ambitious and difficult reform to achieve. Prime Minister Abe has recognized that Japan must reform and deregulate to bring its economy into the 21st century. "...To improve its long-term performance, Japan will have to do what it has been unwilling to do for the last two decades: reform its corporate, financial, industrial, and agricultural sectors. Japan's political system has yet to show the ability to engineer such changes."<sup>68</sup> Abe's Third Arrow attempts to end the endemic protectionism that has typified the Japanese economy for decades. His speeches have touched on reforming labor market rigidity, removing barriers to entry for SMEs, reforming stifling bureaucratic regulations, stimulating critical sectors like FDI and tourism, and exposing protected industries like pharmaceuticals and agriculture to the open market.<sup>69</sup> Through these efforts, Prime Minister Abe is taking the steps necessary to create a competitive and resilient Japanese economy.

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Abe has already stepped forward to deliver on some of these structural reform efforts. In March 2013, Abe announced his intentions for Japan to enter the Trans-Pacific Partnership (TPP) free trade agreement. In August 2013, Japan became a full negotiating partner in the agreement. This considerable free trade zone encompasses 12 Pacific Rim countries (including Japan).<sup>70</sup> Negotiators distinguish this FTA as a “high-quality agreement” that would contain across-the-board reductions in tariffs and non-trade barriers including competition-stifling protections and regulations. By joining negotiations, Abe has demonstrated that his administration is willing to enact wide domestic reforms on some of its most entrenched industries, including agriculture.

Abe also announced his intentions to double tourism and FDI through the Third Arrow agenda.<sup>71</sup> He has boldly endeavored to reduce trade barriers and create an open, transparent, and competitive environment for foreign and domestic firms alike. His efforts have not gone without notice. American investors are watching from the sidelines, eager to invest in the Japanese economy and contribute to growth by working with industry leaders and politicians. Their investment appears hinged on the administration's commitment to reform efforts. In a letter to Sony's CEO Kazuo Hirai, American investor and hedge fund manager Dan Loeb intimates the sentiments of the American business community with poise. “Under Prime Minister Abe's leadership, Japan can regain its position as one of the world's preeminent economic powerhouses and manufacturing engines. The most critical of Prime Minister Abe's “Three Arrows” approach [The Third Arrow] will be unveiled next month: initiatives to create more economic growth in Japan through deregulation and structural reform. Leading business like Sony with leaders like you, Mr. Hirai, can spearhead this important growth.”<sup>72</sup>

Despite this sentiment, U.S. investors are looking for tangible steps by the Government of Japan to show that Abe's efforts are more than rhetoric. They are looking for concrete examples to counter perceptions that the Japanese investment climate remains stacked against foreign firms. In many ways, the litmus test for the Third Arrow's credibility will be made on September 25- The announced allocation for international landing slots at Haneda. The international business community is waiting to see if it will be business as usual or representative of international norms, supporting a transparent, fair, and equitable environment for aviation stakeholders.

## **The Third Arrow and Civil Aviation**

The Prime Minister's reform efforts go across the spectrum of the Japanese economy, touching on various industries, geographies, and communities. Yet one sector that the Administration has failed to mention in its reform efforts is civil aviation. This industry is crucial to the Japanese economy; it is responsible for over one third of Japan's total trade flows and much of its tourism industry. Because of the current capacity and regulatory barriers of the industry, civil aviation may also prove to be a significant bottleneck for the 2020 Olympics. Based on the goals of the Third Arrow and our analyses of the critical linkages between aviation and Abe's targeted industries, we have compiled a number of recommendations for the Japanese administration. These policy recommendations can help reform one of Japan's strategic industries while simultaneously removing uncompetitive practices and creating a fair and transparent regulatory environment. As the world turns to Japan in anticipation of its rebirth under Abe, regulators



have the opportunity to demonstrate real reform efforts in one of its most critical and uncompetitive industries.

The following set of recommendations includes four areas of policy focus to both revitalize the aviation industry and increase air transportation capacity. These incorporate established topical research and literature as well as the leveraged policy expertise of CNAS research. Areas of focus include liberalization of the regulatory environment surrounding low-cost carriers (LCCs), increase in Haneda landing slot allocations and allocation transparency, conversion of Yokota military base to dual civil-military use in peacetime, and investment in critical infrastructure projects to facilitate the 2020 Olympic Games.

#### **LOW-COST CARRIER REGULATORY REFORM**

There is room for growth in the low-cost carrier segment of the Japanese airline market. The infrastructure of many of Japan's airports revolves around a two-fold ownership scheme. The central government frequently owns runways and taxiways, deemed critical infrastructure for the operation of the airport. Local governments or private firms often hold the rights to terminals and parking lots. There is an acute revenue disconnect between the central government and property managers of airport facilities. The central government receives revenue for landing fees, which are not tied to profits gained from the terminals. Therefore, airports are unable to leverage reduced landing fees to increase traffic without enacting the central government to do so. This has prevented numerous low-cost carriers from entering the Japanese market, as operating margins are often lower. These LCCs simply do not have the operating margins to allow for such high fees. On average, Tokyo Narita landing fees are more than double the fees at Incheon (Seoul) and Changi (Shanghai) airports. While Narita cut landing fees for international flights by 5.5% in April 2013, this does not account for a large benefit to many carriers, including budget airlines that could drive passenger traffic.

The 1999 Civil Aeronautics Law created a friendlier regulatory environment for Japanese LCCs, liberalizing the licensing procedures and fare approval systems.<sup>73</sup> This has helped facilitate the establishment of LCCs. However, operability and profitability still hamper current ventures. Despite the success of other Asian LCCs, Japanese firms have achieved very slow growth. This can be attributed to limited access to secondary airports, to some degree. In a 2007 empirical analysis, Hideki Murakami also concluded that the Japanese regulatory environment tolerated predatory behavior and drove these LCCs out of potentially competitive markets. Furthermore, he identified a trend of collusive code sharing between ANA and numerous LCCs, also contributing to the uncompetitive environment.<sup>74</sup>

Simultaneously, many of Japan's airports are suffering from overcapacity. While Narita and Haneda handle most of Japanese air traffic, there are still nearly 100 airports operating across the country. State-run airports are frequently running up large debts fueled by a lack of traffic. Many have chronically lost revenue, to the point where there were discussions of full privatization of managing rights for many ailing rural airports while the property ownership would remain in the hands of the public sector.

There has been some growth in the sector as of late. Spring Airlines Japan just announced that it would offer increased service to western Japanese cities and Narita starting in May 2014. While the number of

LCCs provided to consumers is increasing, the competitive landscape remains stifled, dominated by the traditional names of Japanese aviation. LCCs offer a compelling opportunity for the Japanese aviation sector. As noted, many rural districts are not easily accessible (especially to Tokyo). These districts have little demand for air services. However, these airports are critical public infrastructure, providing residents with access beyond the local municipality. In the past, carriers like JAL were asked to provide service to these regions, despite their stark unprofitability. These domestic routes contributed significantly towards JAL's sustained losses and its eventual restructuring.

By liberalizing the environment surrounding LCCs and airport fees, the Japanese government can encourage a regulatory environment where service to these removed locales can be restored while still retaining a degree of profitability as they are served by LCCs. This would in turn allow full-service national carriers the latitude to leverage their own competitive advantages and not serve on unprofitable lanes. This would be a positive sum gain for LCCs looking to establish further in Japan, full-service carriers avoiding unattractive routes, and Japanese consumers benefitting from increased connectivity.

Based on the evidence and the current challenges faced by LCCs, we suggest three sets of regulations to help spur air traffic while also creating a more open and competitive landscape:

- Allow airport management companies (including both local governments and private firms) full ownership of runways. This will allow greater pricing competition and the ability to adjust landing fees.
- Enforce landing fee caps across Japan. Narita International has taken steps to decrease fees by incentive programs. However, rising landing fees will further lock out future innovators and competition that LCCs bring to the market.
- Encourage an industry-led discussion on how reform of the LCC market can restore service to removed areas of Japan, filling gaps in the aviation market while still supporting profitability for flagship carriers. By advocating regulatory reform and not dictating air service on a given route, the Government of Japan can demonstrate its commitment to market-based solutions.

## **HANEDA SLOT EXPANSIONS**

As discussed earlier in this report, Haneda is at the center of the Japanese aviation market. Based on available data, our calculations estimate nearly 70% of Japan's total air passenger travel through Haneda (as referenced above in 'Japan in the Global Aviation Network'). It is the world's fifth busiest airport, and second in Asia, only behind Beijing Capital International Airport. Both JAL and ANA have hubs stationed at Haneda; it is the core of Japan's aviation market.

Despite its crucial role in both the Japanese economy and the wider global marketplace, there are still critical competitive barriers and opaque regulatory frameworks that surround Haneda. American carriers are at a distinct competitive advantage due to the short-haul limitations on daytime outbound flights. Limited international slots create an acute capacity crunch and a disharmonious competitive environment for aviation players. Allocations are politicized and do not reflect industry best practices.

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There is a strong body of evidence correlating airport expansion with increasing net benefits for the surrounding economy. One such study, “Spatial Benefit Incidence Analysis of Airport Capacity Expansion: Application of the SCGE Model to the Haneda Project,” developed an extremely complex model to map the expansion of Haneda slots to direct economic gain for the Tokyo region. Unlike standard transportation demand forecasting models, this model incorporates microeconomic decision-making and behavior theories. It found that, “slot increases lead to rescheduling of flight plans and finally to change in levels of service. Airline competition in aviation markets may reduce the price of air tickets, and increasing the frequency of flights may also reduce waiting times and therefore the average travel time.”<sup>75</sup> In analyzing a 10% slot increase at Haneda at a net cost of 180 billion JPY (pegged to 1995 values), the authors found that the social net benefit was 33 billion JPY per year. Of this 33 billion, 11 billion JPY went back to the Tokyo metropolitan area while 22 billion JPY was returned to other rural regions of Japan through increased consumption and ticket purchases. Through this study, direct expansion of slots at Haneda can not only improve the competitive environment for both consumers and airlines, but also directly stimulate consumption. Industry experts agree with this analysis; for instance, Hiritoaka Yamauchi, a professor at Hitotsubashi University and acclaimed transportation expert, contends that Haneda slots should be allocated on purely consumer benefits.<sup>76</sup>

In discussions leading up to the previous domestic slot allocation increases as well as upcoming international allocations in October 2013, industry stakeholders have been weighing in on the allocation process. As mentioned above in ‘Endemic Regulatory Challenges’, ANA CEO Ito has consistently levied for increased allocations at the expense of JAL. He argues that the JAL restructuring put ANA at a competitive disadvantage, and has called on regulators to even the competitive landscape. Hajime Tozaki, professor at Waseda University specializing in transportation policy, agrees in part with this analysis. However, he caveated this in an interview with *The Japan Times* last September: “One of the biggest reasons behind JAL’s bankruptcy was the intervention of politics. If such intervention comes back due to the recent argument over unfairness (of JAL’s rehabilitation process), the carrier will return to its old self. That would be a huge loss for Japan’s economy.”<sup>77</sup>

Based on this evidence, Japan should consider the following policy recommendations regarding Haneda’s regulatory environment to spearhead Prime Minister Abe’s Third Arrow reforms:

- Increase slot availabilities to both domestic and international destinations in advance of the 2020 Tokyo Olympic games.
- Allow long-haul daytime departure and arrival slots at Haneda to allow for increased capacity while widening the potential net of passenger destinations. This will bring both increased consumption and profitability to both the Tokyo area and aviation players
- Ensure fair and equal distribution of slots, either neutrally or per consumer benefit, to maintain a competitive market. This would send a message to the world’s investment community of the Administration’s commitment against politicized regulations and influence peddling in Japan’s industries.
- Establish a Blue Ribbon Council, staffed by industry experts and stakeholders, academic researchers, and policymakers. This Council will serve as a third-party observer to the allocation process, leveraging industry expertise to help ensure a transparent and equitable process.

Establishing this Council will help further demonstrate the Abe administration's commitment to fair and equitable allocations.

#### YOKOTA MILITARY TO CIVIL-MILITARY TRANSITION

Beyond addressing regulatory challenges to market entry barriers and landing slot allocations in civil aviation, general airport capacity remains a persistent issue in Tokyo. Growing traffic at Haneda will eventually reach capacity and require additional capital investments in runway infrastructure. While expansion efforts are underway at both Narita and Haneda, liberalization of the industry will encourage increased traffic to Tokyo's main airports. The 2020 Olympic Games will put even additional strain on the region's airport capacity. In all likelihood, passenger demand may well outstrip the capacity of both Haneda and Narita in the years to come.

Yokota has a 10,000 ft. runway, capable of handling both narrow- and wide-body aircraft. Both MITRE and the International Civil Aviation Organization (ICAO) have evaluated the technical viability of Yokota's runway for civil aviation use. The runway has passed all certifications except for the new Airbus A380, which falls under the ICAO 4F Aerodrome classification.

As part of a larger effort to revitalize and reform the civil aviation industry, Japan should pursue the introduction of civil aviation use of Yokota as a complementary airport to the Tokyo metropolitan area. While Narita and Haneda serve East and South Tokyo, West Tokyo remains removed from any major air hub. As noted in *Yokota: Civil-Military Use of U.S. Bases in Japan*, "If civil aviation could be introduced without undermining Yokota's principal purpose as a military base, then shared use could fundamentally rebalance civil aviation in Tokyo. It would also restore Tokyo's competitiveness as an aviation gateway and as a business center. The positive effect of strengthening Tokyo's infrastructure and business profile should be a prime consideration of U.S. alliance managers."<sup>78</sup> The following specific policy recommendations should be considered:

- Implement Yokota as a dual use civil-military airport. This will help rebalance capacity constraints as well as provide airport access to underserved districts of Tokyo.
- Encourage dual use as a method to advance bilateral dialogue on regulatory challenges and competitive barriers faced by stakeholders in Japanese civil aviation.
- Leverage shared U.S.-Japanese stakeholder responsibility as a method of ensuring slot allocations at Yokota are decided openly, transparently, and by industry best practices (IATA WSG). There is an opportunity to begin allocations at Yokota under a different regulatory regime, advancing a more fair and competitive system than the one currently in use.
- Make capital investments to expand infrastructure capacity at Yokota. Doing so will help divert excess traffic from Haneda in advance of 2020.
- Use the introduction of civil aviation at Yokota as a way of facilitating more military contingency-time access to other civilian airports in Japan.

## 2020 OLYMPIC GAMES

The 2020 Olympic Games have the potential to bring upwards of 8 million tourists in and out of the Tokyo metropolitan region in the span of 28 days. The Games will bring considerable investment and spending to Tokyo, stimulating growth and helping to deliver on Abe's Third Arrow reform efforts.

Based on the current regulatory and competitive environment in Japanese civil aviation, the industry simply is not adequately prepared to mitigate this influx of tourists. There are critical limitations to passenger capacity at Narita given its curfew from 11 PM to 6 AM. Haneda does not currently accept long-haul international flights during its daytime operations. Normally technical and transparent decision making regarding capacity allocations is fraught with influence peddling and politicization. The above policy recommendations take steps to address these inefficiencies. Below, we recommend a set of more ambitious, long-term policy goals for the Abe administration to increase capacity while truly deregulating and reforming the industry. They are as follows:

- By 2018, ensure that slot allocations adhere to IATA World Slot Guidelines, the internationally recognized best practices for fair and equitable capacity management.
- Establish a joint government-industry task force to correct misconceptions and establish working goals for the future of Tokyo's civil aviation space. This task force should incorporate both foreign and domestic industry stakeholders as well as key bureaucrats from MLIT's Civil Aviation Bureau.
- Utilize new policy councils to both receive industry-critical information as well as provide a forum for inclusive policy development. This would encourage cooperation and communication between established domestic carriers like JAL and ANA. New policy councils of note include the Industrial Competitiveness Council and the Regulatory Reform Council, established by Abe's administration in January 2013.



## SUMMARY

Japan's aviation industry is at a critical juncture. It is a central aspect of the Japanese economy, supporting hundreds of thousands of jobs and facilitating travel for millions of tourists and business professionals alike. Efficient air travel is critical to facilitate trade and investment, especially in the case of this island nation. With the tremendous prospects for continued growth and economic revitalization under Prime Minister Abe, coupled with the economic boon of the upcoming 2020 Olympic Games, Japan's aviation industry has the potential to provide a catalytic stimulus to the Japanese economy.

Yet despite its importance and visibility to the Japanese economy, aviation is extremely uncompetitive, entrenched in political venality and opaque regulatory barriers. These systemic challenges are notable, as they are the expressed targets of Abe's Third Arrow reforms. Foreign firms and governments alike are watching current efforts unfold with great attention. While Abe's first Two Arrows are moving forward, the Third Arrow is a litmus test for the administration's commitment to effective structural reform. Stepping up against such protected industry forces are a considerable test of Abe's political will and resolve. In many ways, the symbolic and actual benefits of civil aviation reform—in particular the politicized yet highly visible allocation process—present a fundamental choice for Prime Minister Abe and his team. It will either be 'business as usual' or indicative of a new and revitalized investment climate.

The political risks associated with such reforms, particularly in the aviation sector, are tangible. Special interests and corporate interlocutors have a vested interest in maintaining the status quo. Nevertheless, as the world watches and political commentators begin to question whether the scope of the Third Arrow is truly feasible, Prime Minister Abe is presented with an incredible opportunity. By driving forward with his Third Arrow reform efforts and targeting the uncompetitive landscape of the aviation industry, Shinzo Abe can demonstrate that Japan is back in business and cleared for takeoff.

## Taking Off

### Civil Aviation, Forward Progress and Japan's Third Arrow Reforms



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<sup>1</sup> "Japan Loses Civil Aviation," *The Milwaukee Journal*, November 17, 1945, 4.

<sup>2</sup> Robert B. Matchette et al., eds. *Guide to Federal Records in the National Archives of the United States* (Washington, DC: National Archives and Records Administration, 1995).

<sup>3</sup> Jacqueline McFadyen, "U.S.-Japan Civil Aviation: Prospects for Progress," Working Paper No. 97-2 (Peterson Institute for International Economics, 1997).

<sup>4</sup> U.S. Department of State, *U.S.-Japan Air Transport Agreement of December 14, 2009*, Record of Discussions, U.S. Department of State (2009).

<sup>5</sup> Tony Tyler, "Strengthening Japan's Aviation Competitiveness – Reducing Cost of Infrastructure," Press Release No. 37 (International Air Transport Association [IATA], September 19, 2012). IATA is an international industry trade group of airlines, whose mission is to "represent, lead and serve the airline industry". IATA is responsible for a considerable supply of research on civil aviation, including reports on increasing competitiveness, industry best practices, and regulatory frameworks.

<sup>6</sup> "Strong Passenger Growth Trend Continues," Press Release No. 42 (International Air Transport Association, July 3, 2013).

<sup>7</sup> Data compiled from Ministry of Finance's *Trade Statistics of Japan* database. [http://www.customs.go.jp/toukei/info/index\\_e.htm](http://www.customs.go.jp/toukei/info/index_e.htm).

<sup>8</sup> Mizuho Aoki, "Bubble Era's Aviation Legacy: Too Many Airports, All Failing," *The Japan Times*, February 7, 2012.

<sup>9</sup> "World Air Transport Statistics (WATS)," (International Air Transport Association), 2013. This specific metric includes a single count of total passengers arriving, departing, and transiting directly.

<sup>10</sup> This metric is based on the origin and destination pair of passenger itineraries, potentially including intermediate destinations. The coverage is total scheduled traffic, including international as well as domestic traffic.

<sup>11</sup> Steven Brull, "New \$1.36 Billion Terminal Is No Cure-All: Tokyo's Troubled Airport," *The New York Times*, December 3, 1992.

<sup>12</sup> Exorbitant landing fees that made Japanese airfares more expensive than other international fares have added to the transportation problem. See Christopher Johnson, "Haneda Fails to Solve Japan Air Travel Woes," *Asia Times Online*, October 29, 2010.

<sup>13</sup> All Nippon Airways, *ANA Group History*, Passenger Load Data, ANA Holdings, 2013.

<sup>14</sup> Seattle Times Staff, "Jal Reports Loss Narrows; Ana Swings From Profit To Loss," *The Seattle Times*, May 31, 1993.

<sup>15</sup> "Flight Path to New Horizons: 2012 Annual Report," (All Nippon Airways, 2012).

<sup>16</sup> Chris Cooper and Kiyotaka Matsuda, "ANA Close to Decision on 25 Airbus, Boeing Aircraft Order," *Bloomberg*, September 12, 2013.

<sup>17</sup> Katsuro Sakoh, "Privatizing State-Owned Enterprises: A Japanese Case Study," Background Report (Heritage Foundation, 1986).

<sup>18</sup> Naoto Ida and Tohru Tamura, "Effects of Deregulation on Local Air Passenger Demand," *Research in Transportation Economics*, vol. 13 (2005), 211–231.

<sup>19</sup> Harry Garner, "The Economic Downfall of Japan Airlines and Prospects for Reorganization," *Bloomberg Law Reports – Bankruptcy Law* (Bloomberg Finance, 2010), 4, 34.

<sup>20</sup> Garner, "The Economic Downfall of Japan Airlines."

<sup>21</sup> Hiroko Tabuchi, "JAL Bankruptcy Sets Off Reorganization and State-Led Bailout," *The New York Times*, January 19, 2010, B3.

<sup>22</sup> Hiroko Tabuchi, "Dueling Alliances Make Aid Offers to Japan Airlines," *The New York Times*, November 18, 2009.

<sup>23</sup> Vinay Sarawagi, "JAL to Cut 16,500 Jobs," *Reuters*, April 6, 2010.

<sup>24</sup> "Japan Tourism Report Q3 2012," (Business Monitor International, May 2012).

<sup>25</sup> "JAL Report 2013," Annual Report (JAL Group, August, 2013).

<sup>26</sup> "Managing Scarce Airport Capacity: Airport Slots & Worldwide Slot Guidelines (WSG)," IATA Position Paper (IATA, 2013). IATA has developed a wide body of literature on the slot allocation process, in particular. Its semi-annual slot conference, various committees, and supporting economic reports all speak to the importance of ensuring a transparent and fair slot allocation process.

<sup>27</sup> Hirata Terumitsu and Morichi Shigeru, "Comparative Analysis of Domestic Flight Frequency between Japan and U.S. Aviation Markets," *Journal of the Eastern Asia Society for Transportation Studies*, Vol. 8 (2010).

<sup>28</sup> In the given chart, American airports closer to the X-axis service both higher capacity aircraft as well as more narrow-body aircraft as a percent of total flights.

<sup>29</sup> Hun-Koo Ha et al., "Comparative Analysis of Efficiency for Major Northeast Asia Airports," *Transportation Journal*, 49 no. 4 (2010), 9–23.

<sup>30</sup> Landing slot allocations take place biannually— one in the summer months and one in the winter months.

<sup>31</sup> Tim Kelly and Kentaro Sugiyama, "Dogfight over Tokyo: Japan's Big Airlines Vie for Landing Rights," *Reuters*, August 18, 2013.

<sup>32</sup> From Tokyo International Airport (Haneda: HND) Capacity Analysis 2010 White Paper.

<sup>33</sup> Kelly and Sugiyama, "Dogfight over Tokyo."

<sup>34</sup> Much of the information below draws from our previous CNAS study: Patrick M. Cronin, Paul S. Giarra, Zachary M. Hosford and Timothy A. Walton, "Yokota: Civil-Military Use of U.S. Bases in Japan," (Center for a New American Security, October 2012).

<sup>35</sup> Cronin et al., "Yokota." In the aftermath of Tokyo's selection as the host city for the 2020 Olympics, Tokyo Governor Naoki Inose has reiterated calls for introducing civil aviation to Yokota. See "Inose Revives Push to Let Civilian Airliners Use Yokota Air Base," *The Japan Times*, September 15, 2013.

<sup>36</sup> "Tokyo International (HND)," Airport Economic & Social Impacts, (Ecquants, 2012).

<sup>37</sup> "Narita Employees Down 20% from 2009," *The Japan Times*, March 21, 2012.

<sup>38</sup> "2012 Foreign Visitors and Japanese Departures," Statistical Report (Japan National Tourism Organization [JNTO], 2012).

<sup>39</sup> Tyler, "Strengthening Japan's Aviation Competitiveness."

<sup>40</sup> Business Monitor International, "Japan Tourism Report Q3 2012."

<sup>41</sup> The number of Chinese tourists to Japan has been growing. However, recent tensions surrounding the Senkaku/Diaoyu Islands have resulted in many major Chinese travel agencies cancelling trips to Japan. Despite offering multi-entry visas with a lower income threshold (reduced to 60,000 CNY from 250,000 CNY) to Chinese residents in July 2011 to try and attract additional tourists following the Tohoku disaster of March 2011, Chinese tourist companies including China Comfort Travel Group had canceled trips as of September 2012.

<sup>42</sup> Japan National Tourism Organization, *2012 Foreign Visitors and Japanese Departures*.

<sup>43</sup> Cynthia Nyquist, "The March 11 Tohoku Earthquake, One Year Later. What Have We Learned?" U.S. Geological Survey blog, March 9, 2012.

<sup>44</sup> Mari Yamaguchi, "Fukushima Plant Admits Radioactive Water Leaked To Sea," *Huffington Post*, July 22, 2013.

<sup>45</sup> Business Monitor International, "Japan Tourism Report Q3 2012."

<sup>46</sup> As recently as the writing of this report, a TEPCO official was quoted as saying the situation at Fukushima Daiichi was "not under control" during an interview with members of the DPJ. See "Situation at Japan's Fukushima Nuclear Plant 'Not under Control', Says Official," *EuroNews.com*, September 13, 2013.

<sup>47</sup> Justin McCurry, "Tokyo 2020 Olympics: Hugs, Tears, and Shouts of 'Banzai' Greet News of Victory," *The Guardian*, September 8, 2013.

<sup>48</sup> Stephen Harner, "The 2020 Olympics: A 'Fourth Arrow' For Abenomics And Second Term For Abe," *Forbes*, September 10, 2013.

<sup>49</sup> Mark Thompson, "Olympics Win Boosts Japan Stocks," *CNN Money*, September 9, 2013.

<sup>50</sup> "Tokyo's Haneda and Narita airports may get more flights," *The Japan Times*, September 10, 2013.

<sup>51</sup> Frederic Neumman and Izumi Devalier, "Japan's Best Stimulus Bet: Foreign Investment," *Wall Street Journal*, April 11, 2013.

<sup>52</sup> Data synthesized from OECD's Foreign Direct Investment Inflows Data. OECD compiles this report from their own statistical analyses as well as reports from the IMF.

<sup>53</sup> Frederic Neumman and Izumi Devalier, "Japan's Best Stimulus Bet: Foreign Investment."

<sup>54</sup> Stanley White, "Little Sign Abe Can Shake Up Japan's Inbound FDI," *Reuters*, May 20, 2013.

<sup>55</sup> Stanley White, "Little Sign Abe Can Shake Up Japan's Inbound FDI."

<sup>56</sup> "The Economic Impact of Air Service Liberalization," (InterVISTAS-ga<sup>2</sup> Consulting Group, 2005).

<sup>57</sup> Adrian Cooper and Phil Smith, "The Economic Catalytic Effects of Air Transport in Europe," (EUROCONTROL European Organization for the Safety of Air Navigation, July 2002).

<sup>58</sup> Masami Ito, "LDP Returns With All Its Old Baggage," *The Japan Times*, December 25, 2012.

<sup>59</sup> Drawn from the DPJ 2009 Change of Government Manifesto. Democratic Party of Japan, "Putting People's Lives First," Manifesto (2009).

<sup>60</sup> Phillip Y. Lipsky and Ethan Scheiner, "Japan Under the DPJ: The Paradox of Political Change Without Policy Change," *Journal of East Asian Studies*, 12 (2012), 311-322.

<sup>61</sup> "Japan's Shinzo Abe Unveils Cabinet After Voted in as PM," *BBC News Asia*, December 26, 2012.

<sup>62</sup> Government of Japan Cabinet Office Economic and Social Research Institute, "Consumer Confidence Survey," (9 September 2013). The Japanese consumer confidence survey is scaled to 100. A score of 50 is indicative of a neutral consumer confidence, while above 50 is positive and below 50 is negative.

<sup>63</sup> Leika Kihara, "Japan Exports Hit Three-Year High on Weak Yen, Trade Deficit Jumps," *Reuters*, August 19, 2013.

<sup>64</sup> It is interesting to note that while Abe's inflationary policies have been lauded at home, he has received some criticism abroad. The G7 issued a joint statement in February 2013 warning against using domestic policy to target currencies. Despite this admonishment, world leaders at the September G20 Summit agreed against any measures that may lead to a currency war.

<sup>65</sup> Jun Hongo, "Abe Hoping to Prove to the World That Japan Truly is Back," *The Japan Times*, September 10, 2013.

<sup>66</sup> Ben McLannahan, "Abe Prepares Fresh Stimulus Measures," *Financial Times*, January 8, 2013.

<sup>67</sup> Charles Riley, "Japan Unveils \$117 Billion Stimulus Package," *CNN Money*, January 10, 2013.

<sup>68</sup> Daniel Gross, "Japan's Fiscal Crossroads: Will Abenomics Mean Tougher Changes?" *The Daily Beast*, July 26, 2013.

<sup>69</sup> The Economist Press, "Once More With Feeling," *The Economist*, May 18, 2013.

<sup>70</sup> Participating countries include: Brunei, Chile, New Zealand, Singapore, the United States, Australia, Peru, Vietnam, Malaysia, Mexico, Canada, and now Japan.

<sup>71</sup> Jonathan Soble, "Abe's 'Third Arrow' Reforms Leave Investors Hungry for Details," *Financial Times*, June 6, 2013.

<sup>72</sup> Dan Loeb, "Sony Must Focus: letter to Sony CEO Kazuo Hirai," *CNN Money*, May 1, 2013.

<sup>73</sup> Anming Zhang et al., "Low-Cost Carriers in Asia: Deregulation, Regional Liberalization and Secondary Airports," *Research in Transportation Economics*, 24 (2008), 36-50.

<sup>74</sup> Hideki Murakami, "An Empirical Analysis of Inter-Firm Rivalry between Japanese Legacy and Low-Cost Carriers," *Rokko Kobe Japan*, 45 (2007).

<sup>75</sup> Takayuki Ueda, Atsushi Koike, Katsuhiko Yamaguchi and Kazuyuki Tsuchiya, "Spatial Benefit Incident Analysis of Airport Capacity Expansion: Application of SCGE Model to the Haneda Project," in *Global Competition in Transportation Markets: Analysis and Policy Making*, ed. Adib Kanafani and Katsuhiko Kuroda (Oxford, UK: Elsevier, 2005), 181.

<sup>76</sup> Mizuho Aoki, "Relisting Just Starting Point for Rejuvenated JAL," *The Japan Times*, September 19, 2012.

<sup>77</sup> Aoki, "Relisting Just Starting Point for Rejuvenated JAL."

<sup>78</sup> Cronin et al., "Yokota."