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Japan Approaches Takeoff

Civil Aviation as the Third Arrow of "Abenomics"

POLICY BRIEF

By Patrick M. Cronin

If Prime Minister Shinzo Abe is looking to bring about real reform and send a powerful, symbolic shot around the world that Japan is changing for the better, he could probably find no more ready reform than breaking the barriers to far more open skies and civil aviation, both commercial and business. Abe is facing the biggest leadership challenge of his career. Having been returned to Japan's top office last December, having promised to bring Japan back by turning around its long-anemic economy, and having emerged from summer elections with his Liberal Democratic Party (LDP) firmly in control of both houses of the Diet, Abe now must either seize the opportunity for serious structural economic reform or confront deepening skepticism about whether Japan can overcome entrenched interests in order to open and revitalize the world's third-largest economy.

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. It endeavors to promote private investment-led growth by opening Japanese markets and encouraging a more flexible and competitive regulatory framework for both foreign and domestic firms. While the first two Arrows are moving forward, the Third Arrow is a critical indicator of the administration's commitment to effective structural reform.

Abe has identified tourism and foreign direct investment as two critical elements of the Third Arrow, but he should add civil aviation to this list. It is the glue that connects the Japanese economy to the global marketplace, and as such it is strongly interconnected with the industries Abe intends to reform. Yet similar to many critical aspects of Japanese economic vitality, the Japanese aviation industry is beset with regulatory barriers and uncompetitive practices that have become pervasive in Japan today. Capacity is limited and controlled by politicians attempting to score political points. 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.

This policy brief identifies four key areas where the Japanese government has an opportunity to both revitalize the aviation industry and increase air transportation capacity: the civil-military transition at Yokota Air Base; low-cost carrier regulatory reform; slot expansions at Tokyo's Haneda airport; and investing in critical infrastructure projects before the 2020 Olympic Games.

The Civil-Military Transition at Yokota Air Base

The United States took control of numerous military installations across Japan after World War II, including what is now known as Yokota Air Base.[1] Today, it serves as a base of cooperation between the Japanese Self-Defense Forces 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, but it could also become an important part of Japanese civil aviation. 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 make 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.[2]

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 help increase military capacity (both at Yokota as well as possibly increased contingency access to other air fields). Yokota would also need to meet 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 United States continues its strategic rebalance to the Asia-Pacific region and the current LDP administration seeks to deepen its bilateral engagement with the United States, civil operations could help advance a more robust role at Yokota while also cultivating shared commercial ties though civil aviation.

Yokota has a 10,000-foot 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 Aerodome classification.

As part of a larger effort to revitalize and reform the civil aviation industry, Japan should pursue

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the introduction of civil aviation use of Yokota as a complementary airport to the Tokyo metropolitan area. Growing traffic at Haneda will eventually reach capacity and require additional capital investments in runway infrastructure, and passenger demand may well outstrip the capacity of both Haneda and Narita in the years to come. Furthermore, Narita and Haneda serve east and south Tokyo but west Tokyo remains removed from any major air hub. As a previous CNAS report noted, "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."[3]

The Japanese government should therefore consider:

- Implementing 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.
- Encouraging dual use as a method to advance bilateral dialogue on regulatory challenges and competitive barriers faced by stakeholders in Japanese civil aviation.
- Leveraging shared U.S.-Japanese stakeholder responsibility as a method of ensuring slot allocations at Yokota are decided openly, transparently, and by industry best practices.[4] 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.
- Making capital investitures to expand infrastructure capacity at Yokota. Doing so will help divert excess traffic from Haneda in advance of the 2020 Olympic Games.
- Using the introduction of civil aviation at Yokota as a way of facilitating more contingency-time access to other civilian airports in Japan.

Low-Cost Carrier Regulatory Reform

The low-cost carrier segment of the Japanese airline market has room for growth. 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, while governments or private firms often hold the rights to terminals and parking lots. This means that 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 enticing the central government to do so. This has prevented numerous low-cost carriers (LCCs) 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 percent in April 2013, this does not account for a large benefit to many carriers, including budget airlines that could drive passenger traffic.

There has been some recent growth in the sector. 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 Japan Airlines (JAL) and All Nippon Airlines (ANA) 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. 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 benefit LCCs looking to grow in Japan, full-service carriers avoiding unattractive routes and Japanese consumers who would gain increased connectivity.

The Japanese government should consider creating a more open and competitive landscape by:

- Allowing airport management companies (including both local governments and private firms) to fully own runways. This will improve competitive pricing and the ability to adjust landing fees.
- Enforcing 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.
- Encouraging 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

Haneda is at the center of the Japanese aviation market. Based on available data, nearly 48 percent of Japan's total air passenger travel through Haneda. 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.

There is a strong body of evidence correlating airport expansion with increasing net benefits for the surrounding economy. One study found that a 10 percent slot increase at Haneda would have a net cost of ¥180 billion (pegged to 1995 values), but the overall economic benefit was ¥33 billion per year.[5]

The Japanese government should consider reforming Haneda's regulatory environment by:

- Increasing slot availabilities to both domestic and international destinations.

- Allowing 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.
- Ensuring 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 government's commitment against politicized regulations and influence peddling in Japan's industries.
- Establishing 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.

Critical Infrastructure Investments Before the 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. However, the current regulatory and competitive environment in Japanese civil aviation means that the industry is not adequately prepared to mitigate this influx of tourists. There are critical limitations to passenger capacity at Narita given its curfew from 11 p.m. to 6 a.m. Haneda does not currently accept long-haul international flights during its daytime operations. Normally technical and transparent decisionmaking regarding capacity allocations is fraught with influence peddling and politicization.

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In order to increase long-term capacity, the Japanese government should consider:

- By 2018, ensuring that slot allocations adhere to the International Air Transport Association's World Slot Guidelines, the internationally recognized best practices for fair and equitable capacity management.
- Establishing 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 the Ministry of Land, Infrastructure, Transport and Tourism's Civil Aviation Bureau.
- Utilizing new policy councils[6] 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.

Conclusion

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 for 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. 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 for landing slots—present a fundamental choice for Prime Minister Abe and his team. It will either be "business as usual" or indicate a new and revitalized investment climate.

The political risks associated with such reforms, particularly in the aviation sector, are considerable. 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 has an incredible opportunity. By driving forward with his Third Arrow reform efforts and targeting the uncompetitive landscape of the aviation industry, he can demonstrate that Japan is back in business and cleared for take off.

Dr. Patrick M. Cronin is a Senior Advisor and Senior Director of the Asia-Pacific Security Program.

ENDNOTES

1. Much of the information below draws from 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).

2. 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.

3. Cronin et al., "Yokota."

4. Best practices is a reference to the standards set out by the International Air Transport Association; e.g., see, IATA, *Managing Scare Airport Capacity: Airport Slots & Worldwide Slot Guidelines (WSG)*, IATA Position Paper, 2013. 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. 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.

5. Takayuki Ueda et al., "Spatial Benefit Incidence Analysis of Airport Capacity Expansion: Application of SCGE Model to the Haneda Project," *Research in Transportation Economics,* 13 (2005), 181.

6. New policy councils include the Industrial Competitiveness Council and the Regulatory Reform Council, which were both established by the Abe administration in January 2013.

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Center for a New American Security
1152 15th Street, NW
Suite 950
Washington, DC 20005

TEL 202.457.9400
FAX 202.457.9401
EMAIL info@cnas.org
www.cnas.org

Contacts
Kay King
Senior Advisor and
Director of External Relations
kking@cnas.org, 202.457.9408

JaRel Clay
Communications Associate
jclay@cnas.org, 202.457.9429