

# The Political Economy of Hong Kong's “Open Skies” Legal Regime: An Empirical and Theoretical Exploration

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## I. INTRODUCTION

Hong Kong is widely believed to epitomize the practical virtues of the neoclassical economic model. It consistently outranks other countries in terms of the criteria incorporated into the Heritage Foundation's authoritative Index of Economic Freedom. The periodically challenging and potentially

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tumultuous transition from British to Chinese rule has thus far had no tangible impact on its status in this respect. A new post-1997 political configuration, coupled with a series of exogenous shocks (the late twentieth century Asian financial crisis, the 2001-2002 global stock market rout, and environmental hazards such as bird flu and severe acute respiratory syndrome/SARS), and intensifying domestic pressures for greater government involvement in the economy, have inevitably left their imprint on the public policy constellation, but the structural characteristics and operational features of the system have undergone marginal rather than fundamental changes.

A distinction needs to be drawn between the ideal Hong Kong represents and economic realities in the territory. The latter have always deviated from the former (a cluster of stylized facts) and the gap may have grown larger over time in response to forces triggered in the course of modernization (notably, affluence, globalization, social complexity, and technological transformation and communications revolution). The balance between the public and private sector has thus not been entirely static, reflecting a secular trend toward mild government expansion and occasionally cyclical, or rather countercyclical, flurry of public policy initiatives designed to stabilize a temporarily faltering economy. This pattern may have become somewhat more pronounced following the reversion to Chinese rule but additional factors, systematic as well as ad hoc in nature, may have been at work.

Consequently, government spending, aimed at supporting a considerable array of programs, cannot be dismissed as insignificant. By the same token, public regulation of private sector activity should not be portrayed as a peripheral phenomenon. Further, the government has not displayed a strong interest in “rolling back the frontiers of the State” or embracing economic liberalization, via privatization and deregulation. It may thus be legitimately argued that the picture painted by neoclassical admirers of this supposedly last bastion of truly unfettered capitalism does not fully correspond to the institutional setup observed in practice and the divergence is the product of persistent influences, albeit not necessarily of the steady-state variety, rather than a historical aberration.

It may however be inappropriate to insist on a near perfect match between a stylized model and the social milieu whose essence it endeavors to capture and employ merely absolute, as distinct from comparative, yardsticks in assessing its merits. From a relative perspective, Hong Kong, even at this juncture, may justifiably be singled out for its generally faithful, even if not unflinching, adherence to neoclassical economic principles. Government spending continues to account for a comparatively modest fraction of the gross domestic product. More often than not, its revenue exceeds its expenditure and budget surpluses are

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deliberately targeted and carefully managed. Both fiscal and monetary policies (particularly the latter, because of a reliance on a linked-exchange-rate-system with the U.S. dollar as its pivot) tend to be conducted according to predetermined rules rather than in a discretionary fashion. Public regulation is not conspicuous by its absence, but the regime is at the “light touch” end of the control spectrum.<sup>1</sup>

The corollary is that notable departures from the neoclassical ideal deserve careful consideration. This is particularly the case if they are found in areas where there is substantial external exposure. The reason lies in the fact that the desire to maintain a light touch has traditionally manifested itself perhaps most visibly in such areas. Further, Hong Kong has long had an unmistakable international economic orientation, initially as an outward-looking manufacturing center (possibly even earlier as a modest entrepôt before the outbreak of the Korean War in 1950), and subsequently as a prominent service center (following the opening up of China in 1978). Indeed, in recent years, the territory has evolved into a global metropolis performing intermediary-type functions beyond the Asia-Pacific region.<sup>2</sup>

Current and capital account transactions proceed effectively unimpeded in Hong Kong. There are virtually no barriers to foreign trade, in both goods and services, and investment flows—in all its forms. In fact, capital movements are not even tracked in a comprehensive manner. “Sin” taxes are imposed on some imported products, but this does not amount to a quantitatively and qualitatively significant deviation from the norm. More importantly, such selective fiscal measures with modest external implications are generally aimed at correcting market failure (predominantly negative externalities and asymmetric information) rather than shielding domestic producers from foreign competition. Local residents are taxed exclusively on income generated at home. Migratory movements are subject to tighter restrictions, perhaps excessively so, and this is the sole meaningful macro-level posture that does not neatly accord with an otherwise extraordinarily liberal policy architecture.

In specific sector or industrial domains, or at the micro level, government restraint is also noteworthy on the international economic

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1. For a broader discussion of these issues, see Miron Mushkat & Roda Mushkat, *The Transfer of Property Rights from the Public to the Private Sector in Hong Kong: A Critical Assessment*, 35 GLOBAL ECON. REV. 445, 445–61 (2006).

2. This role is methodically explored in DAVID R. MEYER, HONG KONG AS A GLOBAL METROPOLIS (2000).

front, even if it does not always match that exhibited in the macro realm. One intriguing exception to the rule is the aviation industry where a degree of policy rigidity has persisted for a long period of time in that the government has been steadfast in its reluctance to unambiguously embrace the logic of open skies and, from a wider perspective, to unilaterally pursue a laissez-faire agenda (in most other policy spheres, a liberal path has consistently been followed irrespective of the stance of actual/potential trade partners or prevailing international commercial practices). The purpose of this Article is to provide a systematic explanation for that seemingly counterintuitive strategic pattern and to draw appropriate inferences regarding the functioning of international legal regimes, particularly ones shaped by powerful economic forces. This is preceded by a discussion of the evolution of the concept around which the paper revolves and its application in Hong Kong.

## II. TOWARD “OPEN SKIES”

The aviation industry has witnessed dramatic policy and structural shifts since the Great Depression of the 1930's. The directional swings observed and their repercussions have arguably exceeded those seen in other segments of the transportation sector and, with some notable exceptions, possibly elsewhere in the economic space. The United States has exercised strategic initiative on that front, shedding at critical historical junctures established regulatory frameworks and opting for new ones. Given its quasi-hegemonic status during the period in question, and the global nature of the aviation industry, innovative American institutional practices have spread throughout the industrialized world and beyond, albeit not necessarily without encountering any resistance or in a coordinated fashion. Regime adaptation, while not entirely smooth, has thus been an international phenomenon.

Airline regulation is a multidimensional undertaking. From an economic perspective, the two key facets pertain to market entry and exit—price controls and rate regulation are equally salient but merit less attention in this context. The former occurs when an existing airline institutes a service in a market or a combination of markets along a route; it may also take place following an entry into the airline business by a brand new enterprise, an increasingly common pattern in recent years. The latter is a product of service discontinuation in a market by an airline; it may be the result of an independent corporate decision or government intervention. Complex economic considerations drive movement in both directions, although profitability is the principal element in the equation. Socio-political factors feature prominently as well, particularly on the government side.

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The pre-Great Depression or, to be precise, pre-1938 formal control of market entry and exit in the United States was to all intents and purposes nonexistent. The sole restrictions in place concerned safety matters. However, from a practical standpoint, it was not realistically possible to operate an airline on a profitable basis without securing a heavily subsidized air mail contract from the Post Office Department. The Postmaster General thus effectively exercised significant power over market entry. Prior to 1925, the Post Office Department operated its own fleet of aircraft to deliver air mail; the Kelly Act of 1925 led to a dismantling of this service and the emergence of the air mail-subsidized private airline; four carriers evolved into substantial players in the domestic arena and one came to dominate international routes during the 1925-1938 period.<sup>3</sup>

The Great Depression precipitated an attitudinal change regarding government intervention in the economy. The fiscal, monetary, and regulatory authorities adopted a more decisive stance and expanded their institutional capabilities in its wake. In 1938, pursuant to the Civil Aeronautics Act promulgated in that year, the economic side of airline operations was placed under the control of the federal government in a manner reflecting structural and functional principles followed elsewhere in the transportation sector (e.g., the regulation of surface carriers by the Interstate Commerce Commission (ICC)) and other industries (e.g., the control of public utilities such as electricity-generating companies by State public utility commissions). The agency formed to oversee the economic regulation of airlines was the Civil Aeronautics Board (CAB).<sup>4</sup>

The 1938 legislation rendered it illegal to operate a common carrier airline service without obtaining a "certificate of public convenience and necessity" from the CAB. The board also had to determine the airline was "fit, willing, and able" to provide the service and comply with the

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3. See WILLIAM E. O'CONNOR, AN INTRODUCTION TO AIRLINE ECONOMICS 24-25 (6th ed. 2001). For additional insights, see ELIZABETH E. BAILEY, DAVID R. GRAHAM & DANIEL P. KAPLAN, DEREGULATING THE AIRLINES (1985); STEVEN MORRISON & CLIFFORD WINSTON, THE ECONOMIC EFFECTS OF AIRLINE DEREGULATION (1986); PAUL STEPHEN DEMPSEY & ANDREW R. GOETZ, AIRLINE DEREGULATION AND LAISSEZ-FAIRE MYTHOLOGY (1992); Richard H.K. Vietor, *Contrived Competition: Airline Regulation and Deregulation, 1925-1998*, in BUSINESS AND GOVERNMENT IN AMERICA SINCE 1870 345-392 (Robert F. Himmelberg ed., 1994).

4. See O'CONNOR, *supra* note 3, at 1-2. For additional insights, see BAILEY, GRAHAM, & KAPLAN, *supra* note 3; MORRISON & WINSTON, *supra* note 3; DEMPSEY & GOETZ, *supra* note 3; Vietor, *supra* note 3.

Civil Aeronautics Act and the board's own specific functional criteria, commonly referred to as the "fitness requirements." The certification procedure was not necessarily onerous, but it could not be portrayed as liberal either. The CAB practices, as well as the spirit and letter of the underlying legislation, were not strongly geared toward the encouragement of entry into air transportation markets and the fostering of healthy competition. Rather, a fine balance was sought between the conflicting values pertaining to industry structure and performance. The 1958 Federal Aviation Act left these legislative and policy features largely intact.<sup>5</sup>

The control of market exit was also tangibly tightened in response to the concerns triggered by the turmoil of the Great Depression and subsequent paradigm shift in economic theory and its application. After 1938, a certified airline needed to secure CAB authorization to suspend operations in any market on its certificate. This configuration was underpinned by strategic logic reflecting seemingly broad public interest imperatives, as distinct from purely commercial ones. To state it differently, an airline was expected to furnish service rather than merely maximize profits. Flying in commercially unviable market niches in return for being granted a protected franchise to operate in profitable segments was viewed as part of the bargain. In that vein, proceedings to discontinue service often led to public hearings which community representatives endeavored to employ as a vehicle for maintaining the status quo.<sup>6</sup>

The Keynesian foundations of the post-Great Depression economic order proved more fragile than anticipated. Widespread manifestations of macro- and micro-level government failure—culminating in a painful stagflationary episode that stretched over an entire decade of the 1970's—have resulted in another paradigm shift, toward the libertarian end of the policy and ideological spectrum. As events unfolded in that direction, CAB decisions began to follow a less restrictive path, displaying a not previously apparent willingness to accommodate commercially driven demand for market entry and exit, as well as allowing airlines to exercise a higher degree of discretion regarding rates. Such informal

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5. See O'CONNOR, *supra* note 3, at 24–39. For additional insights, see BAILEY, GRAHAM, & KAPLAN, *supra* note 3; MORRISON & WINSTON, *supra* note 3; DEMPSEY & GOETZ, *supra* note 3; Vietor, *supra* note 3.

6. See O'CONNOR, *supra* note 3, at 39. For additional insights, see BAILEY, GRAHAM, & KAPLAN, *supra* note 3; MORRISON & WINSTON, *supra* note 3; DEMPSEY & GOETZ, *supra* note 3; Vietor, *supra* note 3.

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practices have assumed an unambiguously authoritative form following the passage of the Airline Deregulation Act of 1978.<sup>7</sup>

Although its name may suggest otherwise, this landmark piece of legislation did not eliminate post-Great Depression era economic control mechanisms over the aviation industry in one sweep. Rather, deregulatory measures were implemented in a stepwise fashion. In 1981, control over domestic entry and exit effectively ceased. Control over domestic commercial cargo was removed somewhat earlier and control over passenger fares was terminated a year later. By late 1984, the CAB itself was dismantled and its remaining functions were transferred to the Department of Transportation (DOT). Perhaps the most economically significant among those which survived the institutional revamping was the authority over foreign air services—from and to the United States, by both American and foreign airlines—now wielded by the DOT.<sup>8</sup>

Initially, the systematic loosening of government grip over the aviation industry was largely confined to the United States. Other countries were generally reluctant to embrace the underlying philosophical premises and emulate the new practices. The trend toward rolling back the frontiers of the State however evolved before long into an Anglo-Saxon phenomenon, spreading subsequently to Western Europe, and eventually assuming effectively global dimensions. By the mid-1990's, the deregulation of air transportation services reached an advanced stage in terms of its geographic breadth as well as its functional depth, although the process of decontrol had not been entirely smooth and some resistance to the liberal impulses originating from countries firmly committed to shrinking government tentacles has continued to surface periodically (at times requiring the superior bargaining power of the United States to neutralize it, or at least to blunt its sharp edges).<sup>9</sup>

The geographic unevenness of support for deregulation—originally epitomized by the liberal posture of a handful of countries led by the United States and the reticence displayed by most others—has been

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7. See O'CONNOR, *supra* note 3, at 2–3. For additional insights, see BAILEY, GRAHAM, & KAPLAN, *supra* note 3; MORRISON & WINSTON, *supra* note 3; DEMPSEY & GOETZ, *supra* note 3; Vietor, *supra* note 3.

8. See O'CONNOR, *supra* note 3, at 2–3. For additional insights, see BAILEY, GRAHAM, & KAPLAN, *supra* note 3; MORRISON & WINSTON, *supra* note 3; DEMPSEY & GOETZ, *supra* note 3; Vietor, *supra* note 3.

9. See O'CONNOR, *supra* note 3, at 3. For additional insights, see GEORGE WILLIAMS, *THE AIRLINE INDUSTRY AND THE IMPACT OF DEREGULATION* (1993); GEORGE WILLIAMS, *AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY* (2002).

particularly apparent on the international front. The Paris Convention of 1919 enshrined the principle of States' right to exercise sovereignty in the air space over their territory and this has crystallized into one of the three key tenets underpinning air law, the other two being the principles of aircraft nationality—whereby an aircraft must bear the nationality of the State in which it is registered—and cabotage—which grants States full authority with respect to foreign aviation activity undertaken in their airspace, including the power to restrict a foreign aircraft from landing at any of its airports.<sup>10</sup>

The notion of “absolute and unlimited sovereignty” faced competitive challenges at the turn of the twentieth century. Some legal scholars and practitioners adopted Grotius' high seas argument and highlighted the merits of a complete freedom of air space. Others sought practical ways, reflecting prevailing technological capabilities, to limit State jurisdiction, to one thousand feet above its territory, without significantly diluting it. A third group followed a conceptually similar but somewhat less flexible tack by aiming at a compromise formula that would consider the entire air space over a country as national domain, coupled however, with an acceptance of the right of innocent passage through it. The public good attributes of air space (i.e., lack of natural, physical boundaries) and military concerns, which were rife in the period preceding the First World War, eventually tipped the balance in favor of the idea of absolute and unlimited sovereignty, given authoritative expression in the Paris Convention.<sup>11</sup>

As a corollary, States have subsequently enjoyed complete and unfettered control over their air space, being unencumbered by external constraints and exercising wide discretion in regulating air traffic flows within their borders. National air space has thus been “de jure closed for foreign aircraft and their operators.”<sup>12</sup> At the policy management level, individual governments, through the implementation of national laws, have been exclusively responsible for controlling market entry, exit, competition, prices, airport operations, pace of growth, and reach of the aviation industry. Regulation has for all intents and purposes been a domestic enterprise lacking a salient international dimension.<sup>13</sup> This is not to imply national laws are the sole source of air law; also included in

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10. See Alexander Parets, *Freedom of the Skies: International Law and the Aviation Industry*, 5 GLOBAL TOPICS E-JOURNAL, Article #2007-3, 4–5 (2007), <http://www.anselm.edu/nhiop/research/arc/intaffairs/global+topics/archive/2007+Global+Topics.htm>. For a broader overview, which remains effective today, see BIN CHENG, *THE LAW OF INTERNATIONAL AIR TRANSPORT* (1962).

11. See Parets, *surpa* note 10, at 2–3.

12. Pablo Mendes de Leon, *The Dynamics of Sovereignty and Jurisdiction in International Aviation Law*, in STATE, SOVEREIGNTY, AND INTERNATIONAL GOVERNANCE 483, 484 (Gerald Kreijen ed., 2002).

13. See ANTHONY E. BROWN, *THE POLITICS OF AIRLINE DEREGULATION* 45 (1987).



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this category are multilateral agreements, bilateral agreements, contracts between air carriers and other entities, and general principles of international law.<sup>14</sup>

The doctrine of absolute and unlimited sovereignty both acknowledged and reinforced the status of a country's air space as a highly valuable natural resource. One of its practical upshots was an erosion of support for a potentially laissez-faire approach to international aviation, broadly rooted in pre-twentieth century economic attitudes and conduct, and the emergence of a loose pattern of bilateral agreements between countries possessing airlines, whether privately or publicly owned, and countries to or through which those airlines sought to fly. While this configuration reflected strong domestic/national interests, and was solidly underpinned in the conceptual/legal sense of the term, ad hoc bilateralism imposed considerable costs on the parties involved and its adverse consequences became increasingly obvious in the period leading up to the Second World War.<sup>15</sup>

The representatives of fifty-two States who met in Chicago in 1944 to address the issue, and whose efforts culminated in the signing of the Convention on International Civil Aviation, commonly referred to as the Chicago Convention, were aware of the limitations of the existing arrangements regarding the exchange of traffic rights, or "freedoms of the air"—as well as the control of fares, freight tariffs, flight frequencies, and capacity—and the need to design a more effective governance framework. Competitive imbalances, stemming from differences in the economic burden carried in confronting the Axis powers and market structure, nevertheless impeded progress toward that goal. The United States, whose aviation industry was expected to emerge in far better shape following the termination of military hostilities than those of its allies, favored a shift toward a maximum exchange of traffic rights—as well as the elimination of other relevant restrictions—and its open skies strategy was supported by countries with a small home base—such as the Netherlands and Sweden. By contrast, nations seriously enfeebled by the war—such as the United Kingdom and France—took a distinctly less liberal stance.<sup>16</sup>

The Chicago conference participants did make palpable headway on

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14. See Parets, *supra* note 10, at 3. For additional insights, see CHENG, *supra* note 10.

15. See RIGAS DOGANIS, *FLYING OFF COURSE: THE ECONOMICS OF INTERNATIONAL AIRLINES* 30–31 (3rd ed., 2002).

16. See *id.*

several fronts and, in fact, may be credited with laying the foundation for the orderly and safe development of international air transportation. They failed however, *inter alia*, to reach an agreement on the mutual exchange of commercial traffic rights (the Third and Fourth Freedoms, which allow the mutual exchange of traffic rights between two countries, enabling their respective airlines to carry passengers and freight between their territories; and the Fifth Freedom, which entails a right granted by country A to an airline(s) from country B to carry traffic between A and countries other than B). From the mid-1940's onward, each country has thus negotiated a series of bilateral agreements with trading partners—known as “bilaterals”—anchored in the new “multi lateral” order, whose purpose has been to regulate two-way air transportation services, primarily market entry and related matters such as points to be served and traffic rights, and secondarily flight frequencies and capacity.<sup>17</sup>

A bilateral typically consists of a wide range of Articles elaborately addressing a host of strategic and operational matters, with the economic dimension accorded particular prominence. The heart of these agreements has consistently featured the notion of reciprocity, denoting a fair and equal exchange of rights between countries very different in size and with airlines of different strengths. This has traditionally been encapsulated in an Article containing the words, “[t]here shall be fair and equal opportunity for the airlines of both Contracting Parties to operate the agreed service on the specified routes between their respective territories.”<sup>18</sup> Nevertheless, reciprocity should not be invariably equated with liberalism as during the early phases of the evolution of the post-Chicago Convention regime, bilaterals often displayed a protectionist bias.<sup>19</sup>

Bermuda-style accords, mirroring the air services agreement signed in 1946 by the United Kingdom and the United States in the British overseas territory, were a notable exception to the restrictive norm. They exhibited considerable flexibility regarding Fifth Freedom rights, subject to certain constraints, usually linking their exercise to the end-to-end traffic potential of the routes, and their accommodative characteristics manifested themselves in other areas (e.g., with respect to frequency or capacity on the routes and tariffs), albeit not necessarily in an open-ended fashion (e.g., provisions were incorporated to allow a subsequent review of arrangements relating to frequency or capacity, in the event the interests of an airline were more adversely affected than initially assumed). Bermuda-style bilaterals gained increasing currency as the pace of economic globalization accelerated and gradually superseded the

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17. *See id.* at 31–32.

18. *Id.* at 33.

19. *See id.*

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less liberal accords of the traditional variety in the industrialized world, as illustrated in Table 1.<sup>20</sup>

TABLE 1  
KEY FEATURES OF TRADITIONAL AND  
BERMUDA-STYLE BILATERALS

	TRADITIONAL	BERMUDA-STYLE
MARKET ACCESS	Only specified and limited number of points/routes to be operated by each airline.	
	Few Fifth Freedoms granted.	Several Fifth Freedoms granted but total capacity related to end-to-end (i.e., Third/Fourth Freedom) demand on route.
	Charter traffic rights <i>not</i> included.	
DESIGNATION	Single	Generally single but some double or multiple.
	Airlines must be under substantial ownership and effective control of nationals of designating State.	
CAPACITY	Capacity to be agreed or fifty-fifty split.	No frequency or capacity control but capacity review if one airline too adversely affected.
	Inter-airline revenue pool required (by some bilaterals).	
TARIFFS	Tariffs related to cost plus profit. Approval of both governments needed (i.e., double approval). Wherever possible, airlines should use IATA procedures.	

Adapted from Doganis, *The Airline Business in the Twenty-First Century*, op.cit., p. 21.

The domestically-generated post-1978 deregulatory impulses spilled over into the international arena, further enhancing externally-oriented liberalization efforts, albeit in a persistently uneven fashion from a geographic perspective and hence inevitably with ambiguous results.

20. *See id.* at 33–34; RIGAS DOGANIS, *THE AIRLINE BUSINESS IN THE TWENTY-FIRST CENTURY* 21–23 (2001).

The rise of consumerism in developed countries, the proliferation of competitively-priced (by International Air Transport Association (IATA) criteria) non-scheduled services, and the emergence of Asian airlines operating outside the confines of the IATA tariff system—and thus able to offer superior service standards and capture a growing share of the trans-Pacific and parallel European market—provided the impetus for a selective shift toward greater flexibility in managing bilateral relationships in the rapidly restructuring aviation industry. The non-scheduled service and Asian challenges rendered it difficult to negotiate agreements within the IATA organizational orbit.<sup>21</sup>

The United States spearheaded the deregulation drive, endeavoring to reverse an institutional pattern characterized by a propensity toward a high degree of market concentration. It was initially supported by a handful of small Asian and European countries—such as Singapore and the Netherlands—but before long, a number of larger and economically more prominent nations—such as the United Kingdom—recalibrated their strategies in a similar manner. American negotiators employed access to the vast U.S. market as a bargaining ploy in prodding other countries into fine-tuning bilateral accords along increasingly liberal lines. The revised U.S.-Netherlands 1978 air services agreement set the trend in this respect, evolving into a model emulated in one form or another in a variety of geographic contexts, with or without, notably in intra-European settings, but also in intra-Asian ones, direct American participation. The momentum produced led to an internationally meaningful, albeit not unqualified, acceptance and spread of open market bilaterals during the 1978-1991 period, which is summarized in Table 2.<sup>22</sup>

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21. See DOGANIS, *supra* note 20, at 22–23; DOGANIS, *supra* note 15, at 50–51. For additional insights, see WILLIAMS, THE AIRLINE INDUSTRY AND THE IMPACT OF DEREGULATION, *supra* note 9; WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9.

22. See DOGANIS, *supra* note 20, at 23–30; DOGANIS, *supra* note 15, at 51–60. For additional insights, see WILLIAMS, THE AIRLINE INDUSTRY AND THE IMPACT OF DEREGULATION, *supra* note 9; WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9.

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TABLE 2  
KEY FEATURES OF PRE-1978 AND POST-1978  
"OPEN MARKET" BILATERALS

	PRE-1978 BILATERALS	POST-1978 BILATERALS
MARKET ACCESS	Only to points specified	Open access-airlines can fly between any two points
	Unlimited Fifth Freedoms granted—more in US bilaterals	Extensive Fifth-Freedom rights granted in US bilaterals but still very limited in intra-European bilaterals
	Charter rights not included	Unlimited charter rights granted (in Europe granted earlier under 1956 ECAC agreement)
DESIGNATION	Single—some multiple in US bilaterals	Multiple
	Airlines must be "substantially owned and effectively controlled" by nationals of designating State.	
	Single	Generally single but some double or multiple.
	Airlines must be under substantial ownership and effective control of nationals of designating State.	
CAPACITY	Capacity to be agreed or 50:50	No frequency or capacity controls
	No capacity/frequency controls in liberal bilaterals, but subject to review.	
TARIFFS	Double disapproval (i.e., only <i>both</i> governments can block).	
	To be agreed using IATA country-of-rules origin rules Procedures (in some US bilaterals).	

Adapted from Doganis, *Flying Off-Course: The Economics of International Airlines*, *op.cit.*, p. 58.

The new constellation represented a marked shift toward a less restrictive and more competitive environment for international airlines. The open-market architecture, although incomplete, nevertheless continued to encounter considerable headwinds and was by no means universally embraced. By the early 1990's, the markets for scheduled air transport from and to the United States and Canada were significantly liberalized. Entry posed few problems because of multiple designation and capacity or frequency constraints effectively vanished; the closely regulated tariffs negotiated through IATA channels gave way to a less rigid system of fare zones, with airlines enjoying wide latitude to set their fares anywhere within the relevant agreed zones for each fare type; and measures to control and standardize service were withdrawn. Progress on trans-Pacific routes was substantial but somewhat more modest and the picture within Europe varied from the relatively liberal (e.g., Netherlands, United Kingdom) to the relatively restrictive (e.g., Austria, Greece) ends of the policy spectrum. Beyond this geographic core, liberalization made limited headway.<sup>23</sup>

At that juncture, pressures against bilateralism, even of the enlightened variety, began to intensify. Expert opinion, reinforced by converging political interests, swung in favor of the view that the aviation industry should be normalized, or allowed to function on terms similar to its major international counterparts, rather than as a quasi-public utility. The rigidities inherent in bilateralism, again even if sophisticated in nature, also increasingly came to be perceived as costly impediments to potentially beneficial exchanges in the global economic arena. Last but not least, there was a growing recognition that the aviation industry matured greatly since the deregulation process started in earnest. It was thus fundamentally more resilient than at any point in the past and capable of facing new challenges. These themes were given prominence in the 1992 International Civil Aviation Organization (ICAO) Montreal Colloquium.<sup>24</sup>

Consistent with the pattern observed throughout the liberalization era, the United States was at the forefront of efforts to translate a crystallizing theoretical consensus into concrete action, paving the way for the emergence of the post-1992 open skies regime. New dynamic airlines—such as American, Delta, and United—gained a foothold in the domestic market, displaying effectiveness no longer exhibited by their established

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23. See sources cited *supra* note 22.

24. See DOGANIS, *supra* note 20, at 30–31; DOGANIS, *supra* note 15, at 60–61. For additional insights, see WILLIAMS, THE AIRLINE INDUSTRY AND THE IMPACT OF DEREGULATION, *supra* note 9; WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9.

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predecessors—such as Pan American and Trans World Airlines (TWA)—and they were eager to reap the advantages of economies of scale stemming from the large size of their home market (i.e., lower unit costs) by expanding abroad. An outward-looking strategy was also dictated in this case by competitive constraints faced in an increasingly saturated domestic arena. Commercial U.S. interests thus combined with ideologically and intellectually-inspired bureaucratic ones, channeled through the DOT and the State Department, to propel the policy machine in a markedly more liberal direction.<sup>25</sup>

The specific turning point assumed the form of the first genuine open skies accord signed in 1992, as on similar occasions in past, by the American and Dutch governments. KLM, the Netherlands-based airline and national carrier of the country, did not need to be subtly maneuvered into entering into the agreement as it materially benefited from the 1978 “open market” accord with the United States and was keen to boost its market share on the lucrative routes linking Amsterdam and American destinations. The 1992 agreement, which set the stage for a new phase of international deregulation, retained some of the key feature of its 1978 predecessor—multiple designation of airlines, no frequency or capacity controls, and open charter access—and incorporated new, more liberal ones—open route access (airlines from either country can fly to any point in the other with full traffic rights), unlimited Fifth Freedom rights, no traffic controls unless traffic is too high or too low, airlines free to code share or enter into other commercial accords, permitting break-of-gauge (when an aircraft type changes at a stopping point of a direct flight).<sup>26</sup>

The open skies agreements negotiated in subsequent years, and generally modeled on the 1992 American-Dutch accord, were deemed to be superior from an economic perspective to the open market variants which they replaced, particularly in terms of market access and tariff control. Notably, they provided unlimited access to any point in either country, whereas the previous bilaterals tended to impose restrictions on the number of points that could be served by foreign airlines in the United States. By the same token, unlike during the 1978–1991 period,

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25. See DOGANIS, *supra* note 20, at 31–32; DOGANIS, *supra* note 15, at 61–62. For additional insights, see WILLIAMS, AIRLINE COMPETITION: DEREGULATION’S MIXED LEGACY, *supra* note 9.

26. See DOGANIS, *supra* note 20, at 32; DOGANIS, *supra* note 15, at 62. For additional insights, see WILLIAMS, AIRLINE COMPETITION: DEREGULATION’S MIXED LEGACY, *supra* note 9.

mutual Fifth Freedom rights were granted unconditionally. Regarding tariffs, double disapproval or the country of origin rule gave way to a commitment to refrain from government intervention other than in exceptional circumstances in order to minimize the scope for discriminatory practices, maximize consumer welfare (by shielding service recipients from excessively high or restrictive prices), and furnish airlines with a level playing and commercially productive field (undermined in the preceding years by government subsidies and support). Table 3 summarizes some of the significant features.<sup>27</sup>

TABLE 3  
KEY FEATURES OF US 1978-1991 “OPEN MARKET”  
AND POST-1991 “OPEN SKIES” BILATERALS

	1978-1991 “OPEN MARKET”	POST-1991 “OPEN SKIES” BILATERALS BILATERALS
MARKET ACCESS	Named number of points in each.	Unlimited State—more limited for non-US carriers.
	Generally unlimited Fifth Freedom	Unlimited Fifth Freedom
	Domestic cabotage not allowed. Seventh Freedom not granted. Open Charter access.	
DESIGNATION	Multiple	Substantial ownership and effective control by nationals of designating State.
CAPACITY	No frequency or capacity control.	
TARIFFS	Double disapproval or country-of-Free pricing origin rules.	
CODE SHARING	Not part of bilateral.	Code sharing permitted.

Adapted from Doganis, *The Airline Business in the Twenty-First Century*, *op.cit.*, p. 37; Doganis, *Flying Off-Course: The Economics of International Airlines*, *op.cit.*, p. 65.

27. See DOGANIS, *supra* note 20, at 36–37; DOGANIS, *supra* note 15, at 65–66. For additional insights, see WILLIAMS, AIRLINE COMPETITION: DEREGULATION’S MIXED LEGACY, *supra* note 9.



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The latest American deregulatory initiative provoked an even more determined response on the other side of the Atlantic. While the United States pursued liberalization within a bilateral context, the European Union (E.U.), known until 1993 as the European Community, appropriately went a step further and embraced multilateralism within its confines. Two non-members, Iceland and Norway, also effectively joined the scheme. Moreover, whereas the open skies bilaterals left the nationality rule intact, the E.U. multilateral framework allowed cross-border majority ownership. Because their liberalization drive assumed deeper proportions, the Europeans deemed it essential to implement in parallel a countervailing competition policy designed to prevent market-distorting practices detrimental to institutional efficiency, as well as fairness and transparency, and consumer welfare, broadly encompassing cartels and restrictive agreements, mergers and monopolies, and government aid or subsidies to producers.<sup>28</sup>

The open skies regime continues to evolve, though not necessarily at a breakneck pace, and remains an unfinished enterprise, both geographically and functionally. Many of the accords governing air transportation between the United States and countries outside the E.U., and vice versa, have not progressed beyond the traditional-style pre-1978 or, at best, post-1978 open market stage. The contrast between the patterns observed within the E.U. and between the E.U. and the rest of the world—with some exceptions, such as the United States—is particularly glaring. Asia has not lagged significantly behind, but it is interesting to note that few countries in this dynamic and outward-looking region have consistently sought to fully match the policy reforms originating on both sides of the Atlantic—New Zealand and Singapore may be singled out as the most accommodating and favorably disposed and interested players.<sup>29</sup>

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28. See DOGANIS, *supra* note 20, at 38–43; DOGANIS, *supra* note 15, at 66–69. For additional insights, see WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9.

29. See DOGANIS, *supra* note 20, at 44–58; DOGANIS, *supra* note 15, at 69–74. For additional insights, see O'CONNOR, *supra* note 3. WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9; Rauf Gönenç & Giuseppe Nicoletti, *Regulation, Market Structure and Performance in Air Passenger Transportation*, 32 OECD ECON. STUD. 183, 183–227 (2001); Wolfgang Hubner & Pierre Sauvé, *Liberalization Scenarios for International Air Transport*, 35 J. WORLD TRADE 973, 973–987 (2001); Jim Bergeron et al., *International Transportation Law*, 40 INT'L LAWYER 403, 403–15 (2006); JAGDISH N. SHETH ET AL., DEREGULATION AND COMPETITION: LESSONS FROM THE AIRLINE INDUSTRY (2007); Jacob A. Warden, "Open Skies" at a

By the same token, even in relatively deregulated global market segments the open skies strategy has not been pursued in a functionally comprehensive fashion. Specifically, movement toward the exchange of certain traffic rights has been painfully slow. Perhaps the two most prominent examples offered in this context have been the right of an airline to carry domestic traffic between two airports within the territory of the other signatory country to the bilateral agreement, which constitutes an extension of international flights within that country, referred to in technical parlance as cabotage, and the right to carry passengers between points in two foreign countries by an airline operating wholly outside its home base, commonly termed the Seventh Freedom. Similar resistance to liberalization, indeed more intense in nature,<sup>30</sup> has been encountered with respect to the foreign ownership of airlines.

To make matters worse, adherence to the spirit, and possibly the letter, of the open skies regime has not been invariably strict. The United States, the principal architect and key pillar of the system, has been particularly prone to capitalize on substantial power asymmetries characterizing the relationships between market participants and has at various junctures opportunistically twisted the rules to protect American airlines. Notwithstanding this behavior, the open skies regime has continued to expand both quantitatively and qualitatively. The process has not been smooth or costless from the perspective of all the parties involved, consumers as well as producers. Nevertheless, meaningful headway has been made and the overall gains are assumed to have outweighed the broad disadvantages in terms of relevant economic yardsticks.<sup>31</sup> Given the backdrop, it would be reasonable to expect

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*Crossroads: How the United States and the European Union Should Use the ECJ Transport Cases to Reconstruct the Transatlantic Aviation Regime*, 24 NW. J. INT'L L. & BUS. 227, 227–55 (2003); Ryan Eddings, *Tentative Agreement in EU-US "Open Skies" Talks*, 18 LOY. CONSUMER L. REV. 257, 257–71 (2006).

30. See DOGANIS, *supra* note 20, at 44–58; DOGANIS, *supra* note 15, at 69–74. For additional insights, see Gönenç & Nicoletti, *supra* note 29; Hubner & Sauv , *supra* note 29; O'CONNOR, *supra* note 3; WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9; Bergeron et al., *supra* note 29; SHETH ET AL., *supra* note 29; Warden, *supra* note 29; Eddings, *supra* note 29.

31. See DOGANIS, *supra* note 20, at 19–58; Gönenç & Nicoletti, *supra* note 29; O'CONNOR, *supra* note 3, at 46–67; DOGANIS, *supra* note 15, at 48–74; INTERVISTASCONSULTING, THE ECONOMIC IMPACTS OF THE OPEN SKIES INITIATIVE: PAST AND FUTURE (2005), <http://www.intervistas.com/4/reports/Econ%20Impact%20of%20Open%20Skies%2030Jun2005.pdf>; Dorothy Robyn, James Reitzes & Boaz Moselle, *Beyond Open Skies: The Economic Impact of a US-EU Open Aviation Area*, in DEEP INTEGRATION: HOW TRANSATLANTIC MARKETS ARE LEADING GLOBALIZATION 50 (Daniel Hamilton & Joseph Quinlan eds., 2005), available at <http://transatlantic.sais-jhu.edu/OpenSkies.pdf>; BOOZ ALLEN HAMILTON, THE ECONOMIC IMPACTS OF AN OPEN AVIATION AREA BETWEEN THE EU AND THE US (2007), [http://ec.europa.eu/transport/air\\_portal/international/pillars/global\\_partners/doc/us/eu\\_us\\_study\\_executive\\_summary](http://ec.europa.eu/transport/air_portal/international/pillars/global_partners/doc/us/eu_us_study_executive_summary).

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quintessentially market-oriented polities to unambiguously embrace the system.

### III. HONG KONG RESPONSE

Foreign trade has been the principal engine of growth driving Asian economies throughout industrialization and, where appropriate, beyond. For Hong Kong this has been the case during its entire history and, because of the distinctly modest size of the domestic market, as well as locational influences and the flexible policy framework, on a comparatively much larger scale than witnessed in other parts of the region, with the notable exception of Singapore. International transportation in all its forms has been an integral component of the picture, with substantial resources being channeled into infrastructure supporting it. Hong Kong boasts one of the world's busiest and most sophisticated airport complexes—although the center of gravity for shipping, a land-intensive industry, in Southern China is gradually shifting to the mainland due to the greater availability and lower cost of land across the border—which literally functions as the lifeline of its widely open economy.

Up-to-date statistics regarding the state of the aviation and shipping industries are not easy to obtain due to rapid shifts in key performance parameters. To illustrate Hong Kong's prominence as an aviation hub, it is possible to rely on 2006 figures showing that the territory is served by about eighty-five airlines. Each week over 5,600 flights take place, reaching more than 150 destinations across the globe. In 2006, the Hong Kong International Airport (HKIA) handled approximately 44.45 million passengers and around 3.58 million tons of air cargo. Aircraft movements in the same year amounted to roughly 280,500. Of the 25.2 million visitors to the territory, about 34.2% arrived by air. In value terms, the HKIA processed approximately 37.5%, 30.3%, and 38.1% of the territory's vital exports, re-exports, and imports respectively.<sup>32</sup>

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pdf; IATA, *Airline Liberalisation*, IATA ECONOMICS BRIEFING NO. 7 (2007), [http://www.iata.org/NR/rdonlyres/85EE6A15-43EB-4D34-A13E-418F404091EF/0/890000\\_Airline\\_Liberalisation\\_Summary\\_Report.pdf](http://www.iata.org/NR/rdonlyres/85EE6A15-43EB-4D34-A13E-418F404091EF/0/890000_Airline_Liberalisation_Summary_Report.pdf). For additional insights, see Hubner & Suavé, *supra* note 29; WILLIAMS, AIRLINE COMPETITION: DEREGULATION'S MIXED LEGACY, *supra* note 9; Bergeron et al., *supra* note 29; SHETH ET AL., *supra* note 29; Warden, *supra* note 29; Eddings, *supra* note 29.

32. See Hong Kong Government, Airport and Aviation Services, <http://www.thb.gov.hk/eng/policy/transport/issues/air01.pdf> (last visited on Jan. 24, 2009).

This statistical portrait reflects Hong Kong's position as a leading service center in general and a thriving aviation hub in particular—in the Greater China, Asian, and worldwide context, a global metropolis. The territory has achieved this status despite constraints stemming from the lack of sovereign power. Unlike Singapore, which has carved out a broadly similar niche for itself in otherwise roughly similar circumstances, it does not even qualify as a city State. Nor can close parallels be drawn with Bahrain and Dubai, which apparently are undergoing transformation into large-scale providers of intermediary services against the backdrop of an economic boom underpinned by escalating oil prices. In any case, it is premature to portray these two regional commercial centers as the pivots of an extensive and multidimensional global network.

Lack of sovereign power has limited Hong Kong's room to maneuver in the international arena and has at times imparted a cautious quality to its externally-oriented policies.<sup>33</sup> Nevertheless, the territory has historically exercised a substantial degree of autonomy in economic matters, both on the domestic front and outwardly. It has thus consistently pursued a semi-independent aviation strategy—semi-independent rather than independent because of its position as a British colony and a Special Administrative Region (SAR) of the People's Republic of China (PRC)—and has enjoyed even greater latitude regarding tactical and operational issues. The strategy and its implementation have been sustained by locally-established financial and institutional capabilities.<sup>34</sup>

The transition from British to Chinese rule has had no concrete legal and policy repercussions on Hong Kong's freedom of action in the aviation domain. A high measure of continuity from the configuration prevailing during the colonial era<sup>35</sup> to the potentially challenging political constellation to emerge following the absorption into the body politic of a nominally communist State<sup>36</sup> has been technically secured via relevant international (albeit strictly bilateral in nature) legal and constitutional

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33. For an overview, see RODA MUSHKAT, *ONE COUNTRY, TWO INTERNATIONAL LEGAL PERSONALITIES: THE CASE OF HONG KONG* (1997); Roda Mushkat, *Hong Kong's Exercise of External Autonomy: A Multi-Faceted Appraisal*, 55 INT'L & COMP. L.Q. 945, 945–962 (2006).

34. See Hong Kong Government, *supra* note 32.

35. For pre-1997 insights, see Gary N. Heilbronn, *The Changing Face of Hong Kong's International Air Transport Relations*, 20 CASE W. RES. J. INT'L L. 195, 195–224 (1988); Gary N. Heilbronn, *Hong Kong's First Bilateral Air Services Agreement: A Milestone in Air Law and an Exercise in Limited Sovereignty*, 18 HONG KONG L.J. 62–85 (1988); Gary N. Heilbronn, *The Travel Industry*, in *LAW IN HONG KONG 1969–1989* 325, 325–359 (Raymond Wacks ed., 1989); *ESSAYS ON AVIATION AND TRAVEL LAW IN HONG KONG* (Gary N. Heilbronn ed., 1990).

36. See Hong Kong Government, *supra* note 32; YASH GHAI, *HONG KONG'S NEW CONSTITUTIONAL ORDER: THE RESUMPTION OF CHINESE SOVEREIGNTY AND THE BASIC LAW* 465, 465–67 (2d ed. 1999).

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instruments. The Basic Law, which falls into the latter category and carries more practical significance in this context, contains several provisions designed to solidify Hong Kong's status as a semi-autonomous aviation hub. Perhaps most noteworthy in this respect is the injunction to the HKSAR government to furnish conditions and take steps for the maintenance of the territory's position as a center for international and regional aviation (Article 128).

In terms of specific arrangements impinging on strategic management, Hong Kong has been allowed to keep its own aircraft register, albeit in accordance with guidelines formulated by the Central People's Government (CPG) regarding nationality marks and registration marks of aircraft (Article 129). The local register is a branch of its PRC counterpart, and the aircraft of both entities have the same nationality.<sup>37</sup> At the tactical and operational level, Hong Kong is responsible for "routine business and technical management of civil aviation" and the discharge of functions assigned to it under the regional procedures of the International Civil Aviation Organization (Article 130). These encompass the technical administration of airports, air traffic services—communications, navigation aids, and traffic control—and flight operations.<sup>38</sup>

The provisions pertaining to the conclusion of air services agreements are less straightforward, but they leave considerable room for maneuver for the local authorities. A distinction is drawn between three inherently different categories of air services: (1) those between Hong Kong and foreign States; (2) those between Hong Kong and the mainland; and (3) those between Hong Kong and foreign States which stop over in Hong Kong. The power to decide on air services falling into the second category, and operated either by airlines incorporated and having their principal business in Hong Kong or by their PRC counterparts, is vested in the CPG, following consultation with the HKSAR government (Article 131). Similarly, category three-type air services accords are concluded by the CPG, although it needs to take into consideration the "special conditions and economic interests" of Hong Kong and seek the views of its government. Moreover representatives of the latter may take part in negotiations conducted by the CPG regarding such operations (Article 132).

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37. See GHAI, *supra* note 36, at 465.

38. See *id.*

On the other hand, the quantitatively substantial first category involves air services which are to all intents and purposes the sole responsibility of the HKSAR government, albeit subject to the proviso that its actions should be “under specific authorizations” from the CPG (Article 133). All scheduled air services must be regulated by air services agreements or provisional accords (i.e., informal agreements). Within this legal framework, the local authorities make concrete decisions with respect to the rights of landing or flight over Hong Kong of foreign airlines as well as the routes for airlines incorporated in the territory. There are no express constitutional-style provisions for charter or special flights and, as was previously the case, the relevant licensing is undertaken by the Hong Kong civil aviation administration.<sup>39</sup>

This policy pattern, while not devoid of palpable constraints, extends in some respects beyond that observed during the colonial era, when the territory was considered, at the strategic level, part of the United Kingdom for the purposes of international and bilateral air service accords, and was deemed to be a source of lucrative business for British airlines. The post-1997 legal architecture does not furnish a mechanism whereby mainland airlines could tangibly benefit from the exchange of landing rights and scheduled air services in Hong Kong with foreign States. The role of the CPG, both actual and potential, particularly the latter, should not be minimized.<sup>40</sup> The constitutional arrangements and power dynamics may tempt the authorities in Beijing to intervene, but there is no solid precedent to suggest this is a realistic prospect. For the foreseeable future, Hong Kong is likely to enjoy a high degree of autonomy in tactical and operational matters—coupled with a meaningful, albeit not unlimited, measure of strategic independence and corresponding obligations.<sup>41</sup>

During the early phases of the post-1997 international realignment, mainland corporate State and State-influenced interests, notably the China National Aviation Corporation (CNAC) and Citic Pacific (the latter is in fact incorporated in the territory and publicly traded on its stock market), sought to build a stake in the two principal Hong Kong “designated” airlines, Cathay Pacific and Dragonair. This may have constituted an attempt to establish a channel for exercising, directly and indirectly, greater control over aviation policy in a capitalist enclave that is being reabsorbed into China, yet within a potentially problematic loose politico-economic framework, and an industry widely perceived as

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39. *See id.* at 466.

40. *See id.*

41. *See* Mushkat, *Hong Kong’s Exercise of External Autonomy: A Multi-Faceted Appraisal*, *supra* note 33.

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strategic in nature.<sup>42</sup> It is thus interesting to note in this context that this trend has partly been reversed and that deliberate divestment has selectively replaced focused investment as a key corporate goal of the players involved. Cross-border cooperation, primarily between Cathay Pacific and Air China, still looms on the agenda, but it has increasingly commercial underpinnings that have no overtly adverse implications for Hong Kong's ability to chart its own semi-independent course.<sup>43</sup>

An elaborate institutional infrastructure has been erected to sustain this historical pattern well into the future—with the Transportation and Housing Bureau (THB), the Civil Aviation Department (CAD), and the Airport Authority (AA) functioning as its core. The THB exercises overall policy responsibility for civil aviation. Its principal activities include high-level oversight over the work of the CAD, liaison with the AA regarding civil aviation-related matters, and the conduct of air services negotiations (with the Air Services Division of the CAD playing a supporting role). The CAD and AA, the two policy implementing organizational arms, are responsible for civil aviation management and for providing, operating, maintaining, and developing the HKIA respectively.<sup>44</sup>

As matters stand, the AA functions as a government-owned statutory corporation subject to terms stated in the Airport Authority Ordinance. The board overseeing its activities however comprises non-public officers as well as public ones. Moreover, the AA is legally bound to conduct its business according to sound commercial principles. Indeed, its privatization in one form or another may be undertaken in the not too distant future. Private sector participation in the provision of airport services has traditionally been widespread and this remains the case today. Further material progress in that direction, which is expected soon, barring unforeseen developments, should reinforce Hong Kong's position as a player enjoying considerable autonomy in the aviation domain and one capable of employing strategic, as distinct from merely tactical and operational, discretion in pursuit of its goals.<sup>45</sup>

The latest figures available lend solid support to this conclusion. They show that Hong Kong has thus far signed air services agreements with

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42. See GHAI, *supra* note 36, at 466.

43. See Cathay Pacific Press Release, Hong Kong Strengthens its Role as the Premier Asia-Pacific Regional Aviation Hub Under Shareholding Realignment (June 9, 2006), [http://www.cathaypacific.com/cpa/en\\_INTL/aboutus/pressroomdetails?refID=66b7b40b0e0fb010VgnVCM32000011d21c39](http://www.cathaypacific.com/cpa/en_INTL/aboutus/pressroomdetails?refID=66b7b40b0e0fb010VgnVCM32000011d21c39) (last visited on Jan. 24, 2009).

44. See Hong Kong Government, *supra* note 32.

45. See *id.*; Mushkat & Mushkat, *supra* note 1.

fifty-eight different countries across the globe: (Australia, Austria, Bahrain, Bangladesh, Belgium, Brazil, Brunei, Cambodia, Canada, Croatia, the Czech Republic, Denmark, Estonia, Ethiopia, Finland, France, Germany, Greece, Hungary, Iceland, India, Indonesia, Israel, Italy, Japan, Jordan, Kazakhstan, Kenya, Kuwait, Luxembourg, Malaysia, Mauritius, Mexico, Mongolia, Myanmar, Nepal, the Netherlands, New Zealand, Norway, Pakistan, Papua New Guinea, the Philippines, the Republic of Korea, Oman, Qatar, Russia, Saudi Arabia, Singapore, South Africa, Sri Lanka, Sweden, Switzerland, Thailand, Turkey, the United Arab Emirates, the United Kingdom, the United States, and Vietnam). Overflight accords have also been signed with a number of countries (the Maldives and former Soviet Republics such as Belarus, Kyrgyzstan, Lithuania, and Ukraine).<sup>46</sup>

There is no concrete evidence to suggest such agreements heavily draw their inspiration from Beijing, an observation that apparently applies, albeit perhaps not to the same extent, with respect to Macau, the former Portuguese colony, and as of 1999 another special administrative region of the PRC.<sup>47</sup> China has been negotiating its air services agreements with other parties, where the interests of Hong Kong and Macau are not directly involved, in its own way and at times with different consequences. Its style in approaching these matters has definitely, and understandably, diverged from that of the two special administrative regions. The gap between the final products may have been less pronounced, because air services accords inevitably display a certain degree of uniformity in key areas, but this does not detract from the fact no full convergence has taken place.<sup>48</sup>

Plans are formulated to insure that Hong Kong possesses the necessary physical, as well as institutional, capabilities to continue progressing smoothly along its semi-independent path. According to the HKIA 2025 Blueprint, which reflects its long-term goals and corresponding projections, the AA is expected to take systematic steps toward establishing a seamless network of air, rail, road, and sea links in order to solidify HKIA's role as the pivot of a well-integrated multimode transportation system connecting the entire Pearl River Delta region to a wide range of

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46. Hong Kong Government, *supra* note 32.

47. For an overview, see José Tomás Baganha, *Macau Civil Aviation and Recent Developments in Air Carrier Liability*, 28 HONG KONG L.J. 90, 90–103 (1998).

48. For an overview, see Gabriel S. Meyer, *U.S.-China Aviation Relations: Flight Path Toward Open Skies?*, 35 CORNELL INT'L L.J. 427, 427–56 (2002); Alex Burkett, *China's Two-Dimensional Skies: The "Chineseness" of Aviation Law in China and How it Helps us to Understand Chinese Law*, 16 J. TRANSNAT'L L. & POL'Y 251, 251–74 (2007); Jiangtian Xu, *Open Skies Agreement between China and European Union: Paper for Intensive Program of Master of Euroculture Program* (undated), available at <http://www.euroculturemaster.org/default.aspx?sec=3&sub=4>.



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international destinations. It is estimated that the HKIA will annually serve about 80 million passengers and handle approximately 8 million tons of cargo, seeing around 490,000 aircraft movements in the process, in 2025. The AA and CAD are collaborating closely in an effort to maximize the capacity of the existing two runways and the former is to embark on a feasibility study focusing on the construction of a third one.<sup>49</sup>

On the face of it, this is a backdrop conducive to policy boldness, flexibility, and innovation. Given the deeply entrenched laissez-faire bureaucratic culture, constitutionally-derived—and arguably rooted in international law—scope for autonomous action, impressive financial resources, and substantial institutional and physical capabilities, Hong Kong should to all appearances bask in the limelight as a pioneer in deregulating the aviation industry in general and resolutely embracing the open skies architecture in particular. Yet, as matters stand, the territory is accorded scarcely any attention in major studies devoted to the liberalization of air services in Asia, where countries not known for a single-minded commitment to the neoclassical economic credo feature prominently,<sup>50</sup> and its adherence to open skies principles, let alone their dedicated promotion at home and abroad, has been rather lukewarm.<sup>51</sup>

It is a moot point whether Hong Kong should be realistically expected to be at the forefront of the movement to deregulate the aviation industry in Asia, as distinct from being selectively viewed as a potential model for others. Because of its small size, the domestic market for air services is virtually nonexistent and this normally constitutes the principal target for liberalization efforts, at least during the initial phases of the restructuring process. By the same token, with some exceptions, the territory's aviation industry has historically not been the subject of tight economic regulation, the noneconomic side, including safety, has been much more closely managed by the government. The corollary is that

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49. See Hong Kong Government, *supra* note 32.

50. See FLYING HIGH: LIBERALIZING CIVIL AVIATION IN THE ASIA PACIFIC (Gary C. Hufbauer & Christopher Findlay eds., 1996); ASIA PACIFIC AIR TRANSPORT: CHALLENGES AND POLICY REFORMS (Christopher Findlay, Chia Lin Sien & Karmjit Singh eds., 1997); DIPENDRA SINHA, DEREGULATION AND LIBERALIZATION OF THE AIRLINE INDUSTRY: ASIA, EUROPE, NORTH AMERICA, AND OCEANIA (2001).

51. See KAI-SUN KWONG, TOWARDS OPEN SKIES AND UNCONGESTED AIRPORTS: AN OPPORTUNITY FOR HONG KONG (1988); C.K. Law & Raymond Yeung, *The Reality of "Open Skies" and its Relevance for Hong Kong*, Hong Kong Policy Research Institute Research Press Briefing, Apr. 5, 2000, <http://www.hkpri.org.hk/passagesPDF/policyGroupReport/2000/The%20Reality05April00.pdf>.

the Hong Kong experience perhaps does not provide illuminating insights into the challenges posed by the liberalization of air services and, for this reason, may have not attracted strong interest on the part of policy analysts.

Such defensive logic cannot be readily applied to strategies directed at open skies arrangements. This is a regulatory domain where, in principle, ardent proponents of laissez-faire tenets and policies might venture beyond the kind of progressive bilateralism emphatically preached and selectively practiced by the United States. A compelling argument could be put forth that, irrespective of the paths followed by other players in the global aviation arena, Hong Kong should open its skies unconditionally. This would not be tantamount to free entry and thus need not conjure up uncomfortable images of disorderly market conditions. There are sophisticated institutional mechanisms for controlling access without undermining efficiency, equity, and freedom and the local bureaucracy is well-versed in their structural features and has acquired considerable experience in operating them. Notably, landing rights can be economically and fairly allocated to airlines via auction in a manner similar to the process relied upon in making public land commercially available to private property developers in the territory.<sup>52</sup>

Designing and implementing a scheme embodying such seemingly radical characteristics, while not technically infeasible, may prove to be an inherently difficult undertaking, even in a highly favorable politico-strategic climate. The possibility that Hong Kong, its apparent neoclassical policy mindset notwithstanding, could somehow fall short of being able to stretch the prevailing rules that far, effectively abandoning them altogether and proceeding in a solo fashion, on a scale that would be unprecedented in the aviation industry, should not be ruled out altogether. If this were the case, it would still be reasonable to expect the territory to adopt a maximalist version of the existing bilateral formula. After all, the content parameters are not rigid and the loose multilateral underpinnings of the system leave ample scope for any two countries to vary them according to specific interests and circumstances.

Content is merely one of a number of pivotal elements in the equation. Geographic breadth, pace of adoption, and the extent of the initiative displayed in the process loom potentially large as well. The geographic network of bilateral accords may be wide or narrow, open skies-type innovations may be implemented expeditiously or slowly, and the parties involved may exercise leadership in promoting relevant functional

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52. See Miron Mushkat & Roda Mushkat, *The Allocation of Ultra Scarce Property Rights in Hong Kong: A Policy Evaluation*, 39 *INTERNATIONALES ASIENFORUM: INT'L Q. FOR ASIA STUD.* 137, 137–61 (2008).

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frameworks—at home and, more importantly, beyond their borders—or opt for a generally passive role. The geographic breadth factor however does not merit further examination here—as distinct from other jurisdictional contexts. It has already been shown that Hong Kong is able and willing to enter into bilateral agreements with a truly wide range of countries from different parts of the globe and that the elaborate network of commercial relationships which it has keenly established is highly heterogeneous in nature from a politico-economic perspective.

On the other hand, pace and initiative, particularly of the regional and international variety, is a legitimate issue for critical consideration. It has been previously noted that not all Asian, or, for that matter, European, countries have reacted to the American economic liberalization drive at roughly the same speed. New Zealand and Singapore have been singled out for being more responsive than others. By the same token, the open skies architecture has been the subject of occasional efforts, which have not necessarily borne fruit, to substantially enhance it. An example of an ambitious initiative of this nature is the European Commission's blueprint for a Transatlantic Common Aviation Area (TCAA) which “would not simply comprise the standard exchange of rights under open skies. It would also set the stage for negotiating beyond the classic five freedoms, and comprise a shared and completely open market environment.”<sup>53</sup> The fundamental premise in this context is that, given the overall strategic backdrop, Hong Kong should be a fast mover and that, where appropriate, it should be at the forefront of such initiatives.

Yet, other than in terms of geographic breadth, Hong Kong's performance can be said to have fallen short of economically well-grounded expectations. Despite strong exhortations to this effect from libertarian policy analysts, the territory has not unambiguously opened its skies on an indiscriminating basis. Quite the contrary, it has consistently favored bilateral arrangements and has vigorously espoused their merits. Suggestions for genuinely market-style unilateral action, with no traditional insistence on full reciprocity, have been rejected as conceptually dubious and practically flawed. This attitudinal constellation has undergone no palpable transformation in the face of dramatic shifts in the global aviation industry and marked changes in local politico-economic conditions.<sup>54</sup> Even China's gradual embrace of the open

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53. See DOGANIS, *supra* note 20, at 55. For additional insights, see DOGANIS, *supra* note 15, at 71–74; Warden, *supra* note 29; Eddings, *supra* note 29.

54. See KWONG, *supra* note 51; Law & Yeung, *supra* note 51.

skies platform (albeit the bilateral version) has had no ramifications in this respect.<sup>55</sup>

The second content-related question, whether the prevailing rules of the bilateral open skies regime have been fully utilized, must also be answered in the negative, although less emphatically so. On the positive side, Hong Kong has effectively dispensed with rigid restrictions requiring airlines to be predominantly owned by nationals of the designating State. Cathay Pacific, the leading “local” carrier, which has recently acquired Dragonair, was founded by an American and an Australian, and has been significantly controlled throughout its history by corporate entities with British colonial roots (Butterfield & Swire and Swire Pacific). The Air China stake in the airline amounts to merely 17.5% and Swire Pacific, a Hong Kong based conglomerate but one that cannot be portrayed as a national organizational vehicle, even though its stake in Air China has been lifted to 20% following the 2006 realignment, continues to be the most prominent shareholder.

On the negative side, the local government has steadfastly adhered to the “one route-one airline” policy, principally in relation to Cathay Pacific and Dragonair at relevant junctures. The underlying argument is that, if a certain route is adequately served by an operating airline, opening it to another would not be an economically compelling proposition. The reason apparently lies in the fact that this would lead to excess capacity, deterioration in airline profitability, erosion of service standards, and loss of consumer welfare. The available empirical evidence—obtained elsewhere—does not lend solid support to such assertions. Alternative justifications may conceivably be invoked for this purpose, but the economic logic relied upon is not entirely sound. Competitive pressures are indeed substantially reduced as a result, yet the consequences, in terms of producer efficiency and benefits to the consumer, are less favorable than the official line suggests.<sup>56</sup>

Nor has the pace of implementation of the open skies platform has been particularly impressive. It is not easy to generalize over the relevant time period and across the whole geographic spectrum, but at least during the initial phases and in key areas, or vis-à-vis major players, progress has been distinctly unhurried. The Hong Kong economic regime is far more liberal overall than that of the United States and it is uncommon for American policy makers to prod their local counterparts into laissez-faire style action, yet this has been the pattern on the open skies front. After negotiations between the two sides had dragged on for years and had culminated in restrictive accords, former U.S. Secretary of

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55. See Meyer, *supra* note 48; Burkett, *supra* note 48; Xu, *supra* note 48.

56. See KWONG, *supra* note 51; Law & Yeung, *supra* note 51.

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Transportation, Norman Mineta, thus somewhat uncharacteristically chose to remind the audience in a speech delivered to the American Chamber of Commerce in Hong Kong on April 19, 2005, that the territory would gain more passengers, more commerce, and stronger airlines by joining the bilateral open skies tide.<sup>57</sup>

The corollary inevitably is that Hong Kong has been a laggard rather than a leader in the deregulation of the international aviation industry. It is perhaps unrealistic to expect a relatively small territory not wielding sovereign power to be a source of bold initiatives in the global arena, other than by example. Opportunities have nevertheless presented themselves over the years to exercise leadership in the regional context. Libertarian policy analysts have put forth recommendations for simultaneous open skies schemes involving a host of Asia-Pacific countries (Australia, Japan, the Philippines, Singapore, Taiwan, Thailand, and the United States) as well as the United Kingdom (by virtue of its position vis-à-vis Hong Kong during the colonial era), but these have not been systematically pursued.<sup>58</sup> Instead, the territory has opted for a low-profile approach and has, from time to time, merely perfunctorily welcomed steps taken toward open skies elsewhere—notably China.

This counterintuitive strategic configuration has attracted virtually no attention on the part of legal scholars. Indeed, the study of aviation law in Hong Kong—encompassing its descriptive, explanatory, and evaluative facets—has largely grounded to a halt in recent years. Economic researchers have displayed greater interest in the subject, producing two broad-based assessments, typically geared toward the evaluative dimension of the topic. The first was undertaken during the early decades of the international liberalization era,<sup>59</sup> and the second is of a more contemporary vintage.<sup>60</sup> Reflecting the progressive evolution of policy throughout this lengthy period, the former yielded a negative verdict and the latter a mixed one. However, neither has adequately addressed the explanatory aspects, nor has shed sufficient light on the persistent gap between “what is” (the actual outcomes) and “what ought to be” (the “ideal” outcomes), and has even tentatively explored the general theoretical implications of

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57. See Press Release, Bureau of International Information Programs, U.S. Department of State, U.S. Official Urges Hong Kong to Liberalize Aviation Market (Apr. 25, 2005) <http://www.america.gov/st/washfile-english/2005/April/20050419135710ajesrom0.6268732.html> (last visited on Jan. 24, 2009).

58. See KWONG, *supra* note 51.

59. See *id.*

60. See Law & Yeung, *supra* note 51.

that divergence. These issues are of considerable significance, in the local context and beyond, and merit a proper place on the academic agenda.

#### IV. QUEST FOR ANALYTICAL EXPLANATION

There is no dearth of conceptual schemes designed to pinpoint factors shaping policy patterns. Some are intended to be comprehensive in nature, encompassing virtually all domains of government activity, and others are tailored to circumstances prevailing in specific spheres of public sector intervention.<sup>61</sup> The ones most pertinent in this context refer to regulatory controls rather than all forms of service provision or equivalent. Since regulation is a predominantly domestic function, they exhibit a strong “home bias”. This nevertheless does not materially detract from their usefulness, because the lack of a pronounced international orientation is not highly inconsistent with extant political realities, or a global power constellation characterized by loose supranational controls. Moreover, the international perspective, while occupying a peripheral position within the overall analytical framework, is by no means completely overlooked.

Several theoretical insights have been generated on the dominant domestic side and meaningful efforts have been made to classify them in a methodical fashion. A number of potentially appealing permutations are thus available for research purposes. The one selected here contains elements that commonly feature in analytical inquiries into the underpinnings of regulatory behavior. Although not exhaustive, it is detailed yet parsimonious. It includes five broad categories: public interest theories, interest group theories, private interest theories, force of ideas explanations, and institutional theories.<sup>62</sup> They are not invariably homogenous and, where appropriate, further subdivision may be necessary. It ought again to be emphasized that they are not ideally suited for dissecting regulation at the supranational level. This need not pose a serious problem however as aviation is subject to a mixture of domestic and bilateral controls. In addition, as indicated, an international conceptual perspective can be incorporated into the analytical scheme.

Public interest theories posit that regulatory activity largely constitutes a response to concerns encapsulated in goals mirroring a desire to maximize community welfare. The underlying assumption is that the

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61. For an overview see MICHAEL HOWLETT & M. RAMESH, *STUDYING PUBLIC POLICY: POLICY CYCLES AND POLICY SUBSYSTEMS* (2d ed. 2003).

62. This classification is adopted in ROBERT BALDWIN & MARTIN CAVE, *UNDERSTANDING REGULATION: THEORY, STRATEGY, AND PRACTICE* 18–33 (1999).

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parties involved are not primarily self-seeking and ultimately function as agents for the public interest. The promotion of parochial objectives is not ruled out, yet it is subject to the condition that self-seeking conduct must be strictly of the instrumental variety and coincide with—or, better still, be subservient to—the pursuit of the public interest (e.g., measures to control private activity may at the same time enhance the reelection prospects of a politician advocating them and consumer well-being). To state it differently, the embedded preferences for the public interest ought to be genuine and terminal.<sup>63</sup>

The notion of maximizing collective welfare through government channels is fraught with considerable difficulties. The concept of public interest is opaque and cannot be readily managed in the political arena. Despite its vagueness and the absence of robust institutional mechanisms to facilitate its articulation, it is deemed to be a workable explanatory tool which may cautiously be employed in dissecting regulatory behavior. The validity of this observation varies from one political setting to another. It applies less effectively to authoritarian polities than liberal ones. The latter provide an institutional environment where, other things being equal, agents for the public interest may carry out their fiduciary duties, within a principal-agent framework, more faithfully than in a nondemocratic milieu resting on fragile legal foundations.<sup>64</sup>

In authoritarian settings, the common good is typically equated with the particularistic, paternalistic, or personal preferences of a specific individual, group or organization, or system. However, this does not imply that in liberal ones it invariably assumes the form of national/social goals which unambiguously supersede private interests. It may be the product of political balancing (featuring the simultaneous fulfillment of key facets of different particularistic aspirations), elaborate compromise (whereby particularistic agendas are scaled back in order to attain a measure of collective equilibrium), and strategic tradeoff (involving tangible

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63. *See id.* at 19–21; BARRY M. MITNICK, THE POLITICAL ECONOMY OF REGULATION: CREATING, DESIGNING, AND REMOVING REGULATORY FORMS 91–108 (1980); Roger G. Noll, *Governmental Regulatory Behavior: A Multidisciplinary Survey and Synthesis*, in REGULATORY POLICY AND THE SOCIAL SCIENCES 9, 18–24 (Roger G. Noll ed., 1985); Robert Baldwin, Colin Scott & Christopher Hood, *Introduction*, in A READER ON REGULATION 9–10 (Robert Baldwin, Colin Scott & Christopher Hood eds., 1998); ANTHONY OGUS, REGULATION: LEGAL FORM AND ECONOMIC THEORY 29–54 (1994); BRONWEN MORGAN & KAREN YEUNG, AN INTRODUCTION TO LAW AND REGULATION: TEXT AND MATERIALS 17–44 (2007).

64. *See sources cited supra* note 63.

concessions to particularistic interests but also concrete sacrifices on their part, an inherently problematic combination yet one that allows progress toward a target selectively embodying the characteristics of the common good).<sup>65</sup>

To complicate matters, perceptions of the public interest are often shaped by forces originating outside the regulatory arena. According to the external-signal theory, institutions charged with serving the common good struggle to come to grips with it because of its elusive nature. Consequently, they observe the responses to their decisions by other parties and draw inferences about the correspondence between these decisions and the hard-to-grasp concept of the public interest. The relevant parties in such circumstances may include the judiciary, the legislature, segments of the executive branch, pressure groups, professional associations, the scientific community, networks of technical experts, the media, constituents, and the public-at-large. Academic-style research selectively conducted by such parties may play a role in helping to crystallize the notion of the common good.<sup>66</sup>

For the most part, the idea of the public interest does not loom large in theories primarily focused on the impact of pressure or interest group activity on regulatory outcomes. Such conceptual schemes tend to place the emphasis on competition for power among groups with divergent objectives, rather than public spiritedness in one form or another, as the key determinant of policy evolution. Certain variants are not entirely inconsistent with the balancing, compromise, or even tradeoff offshoots of public interest theories, but they are generally tilted further away from the idea of common good. These and other variants which fall into that broad category range from open-ended pluralism to narrow-based corporatism. The former centers on the competitive interplay between diverse elements in the political arena and the latter focuses on the selective partnership between the State and prominent corporate entities from which non-participants are to all intents and purposes excluded.<sup>67</sup>

Private interest theories of regulation dispense with the notion of the common good altogether. They are predicated on the assumption that policy is driven by private interests rather than their public or group counterparts, although the distinction between private and group elements at times becomes blurred in the process of analytical elaboration. The non-embracement or abandonment of the common good ideal is believed to

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65. See MITNICK, *supra* note 63, at 92–93.

66. See Noll, *supra* note 63, at 41–52.

67. See MITNICK, *supra* note 63, at 99–111; Baldwin, Cave & Hood, *supra* note 62, at 9–10; BALDWIN & CAVE, *supra* note 62, at 21; OGUS, *supra* note 63, at 69–71; MORGAN & YEUNG, *supra* note 63, at 44–47.



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be the result of goal deflection in regulatory agencies. Such bodies are normally established in order to correct market failure—rooted, for example, in public goods, externalities, asymmetric information, moral hazard, deviations from perfect competition, distributive anomalies—and insure a close alignment between private initiative and community welfare. For various reasons, however, this mission is not pursued in earnest from inception or undergoes significant erosion over time. As a consequence, the regulatory agenda is skewed in favor of private interests.<sup>68</sup>

One explanation offered in this context is that agencies engaged in regulation are in fact set up at the behest of producers in the private sector, individual corporations or corporate networks, rather than to promote the common good, cartel theory. A complementary perspective suggests that the initial intentions of organizational architects are honorable, but that State organs are inherently vulnerable to being effectively taken over by special interests, capture theory. This may sound counterintuitive, yet regulation may yield tangible benefits for producers. Among other things, it may protect them by introducing shared rules for corporate behavior and, like cartelization, foster institutional forms that diffuse competitive pressures (e.g., restrict entry, pave way for concentration of market power, and provide scope for price manipulation). This argument is not without Marxist foundations, but it is developed within a Chicago-style neoclassical framework.<sup>69</sup>

If such theoretical propositions are valid, they cast doubt on the consumer protection hypothesis underlying conceptual schemes that accord primacy to the public interest. According to this viewpoint, whatever their avowed purpose, regulatory agencies do little in practice to protect consumers. Adopting the perversion hypothesis, or asserting that in reality the common good is perverted in the public-private arena, may stretch this logic to uncomfortable extremes. A more accurate reflection is furnished by the no-effect hypothesis, claiming that regulation generates no gains for the community but is a costly undertaking, and its producer protection counterpart, postulating that, contrary to expectations, the actual outcome of regulation is an environment supportive of

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68. See MITNICK, *supra* note 63, at 108–155; Noll, *supra* note 63, at 24–41; Baldwin, Scott, & Hood, *supra* note 63, at 1–12; BALDWIN & CAVE, *supra* note 62, at 21–25; OGUS, *supra* note 63, at 55–75; MORGAN & YEUNG, *supra* note 63, at 43–53.

69. See sources cited *supra* note 68.

uncompetitive business practices attractive to well-entrenched producers.<sup>70</sup>

Private influences on regulation need not originate outside the public sector. Political economists also contend that organizations and officials directly engage in the process may be regarded, for analytical purposes, as self-focused enterprises and entrepreneurs, respectively. At the organizational level, this may manifest itself in the pursuit of objectives geared toward enhancing the interests of the regulatory agency rather than community welfare, the organization in this case is public, but the interests impinging on the performance of its functions—for example, agency-specific budget maximization—qualify as private. At the individual level, similar behavioral patterns may be discerned. Regulators may thus seek to improve their reelection, if politicians, or career, if bureaucrats, prospects instead of channeling their energies into the formulation and implementation of strategies conducive to the common good.<sup>71</sup>

Like their public interest counterparts, private interest theories of regulation are not without their critics who express misgivings about the conceptual underpinnings and empirical fit to behavioral realities. The concerns voiced have to a degree shifted the politico-economic agenda in a slightly different and less ambitious direction by giving rise to agency theories, also referred to as post-revisionist accounts. Such perspectives primarily center on the problems encountered in exercising regulatory control over organizations and individuals. They are typically couched in microeconomic terms, often revolving around the notion of transaction costs. The emergence of this trend, which may be portrayed as complementary rather than competing, should not materially detract from the effectiveness of private interest theories of regulation as a stylized analytical tool capable of selectively yielding illuminating conceptual insights.<sup>72</sup>

Force of ideas explanations of policy development give prominence to intellectual conceptions “which express how and why the government ought to control business.”<sup>73</sup> This time-honored notion is not always rigorously formulated, but it continues to be widely shared. It was vibrantly stated by Keynes, the founding father of modern macroeconomics, who emphatically opined that the “ideas of economists and political

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70. See William A. Jordan, *Producer Protection, Prior Market Structure, and the Effects of Government Regulation*, 15 J. L. & ECON. 151, 151–76 (1972).

71. See MITNICK, *supra* note 63, at 108–155; Noll, *supra* note 63, at 24–41; Baldwin, Scott, & Hood, *supra* note 63, at 10–12; BALDWIN & CAVE, *supra* note 62, at 21–25; OGUS, *supra* note 63, at 55–75; MORGAN & YEUNG, *supra* note 63, at 43–53.

72. See sources cited *supra* note 71; MARVER H. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* (1955).

73. RICHARD A. HARRIS & SYDNEY M. MILKIS, *THE POLITICS OF REGULATORY CHANGE: A TALE OF TWO AGENCIES* 26 (2d ed, 1996).

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philosophers . . . are more powerful than is commonly understood. Indeed the world is ruled by little else.”<sup>74</sup> This seemingly innocuous proposition came to haunt him when his own notions regarding the public regulation of private enterprise came under relentless attack by neoclassical economists and unsympathetic policy makers in the 1980’s. Today, it is perhaps most effectively encapsulated in the concept of loquocentric societies where ideas, if deployed persuasively, may prompt people to act in a manner not entirely consistent with their narrow interests.<sup>75</sup>

Some academic commentators voice skepticism with respect to the force of the ideas themselves, or their content, and are inclined to attribute the impact to packaging. For example, McCloskey cites cynical witticisms circulating in the U.S. Council of Economic Advisers in the 1980’s, which reflect misgivings of “insider” economists about the notion that policy is the product of scientific experiments of the hard-science variety: “Mankiw’s Maxim: No issue in economics has even been decided on the basis of facts. Nihilistic Corollary I: No issue has ever been decided on the basis of theory either.”<sup>76</sup> He proceeds to argue that persuasiveness in economics does not hinge on empirical or logical rigor. Rather, it stems from the ability to successfully employ crucial rhetorical skills in the appropriate political context and thus enhance the appeal of essentially contestable arguments.<sup>77</sup>

Institutional theories of regulation veer even further away from the concept of interest, whether public or private. Their proponents assert that policies are embedded in complex organizational structures which are governed by a plethora of behavior constraining and determining substantive and procedural rules. The scope for consistently maximizing the common good or one’s utility in such settings is distinctly limited. The same holds true for striking intergroup bargains. The rule-bound structures evolve slowly over time and are shaped by a multitude of factors, including ones highly macroscopic in nature (e.g., culture). The

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74. JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY* 383 (1936).

75. See Kenneth Minogue, *Loquocentric Society and its Critics*, 21 *GOV’T & OPPOSITION* 338, 338–61 (1986). See also BALDWIN & CAVE, *supra* note 62, at 26; GIANDOMENICO MAJONE, *EVIDENCE, ARGUMENT AND PERSUASION IN THE POLICY PROCESS* (1989); CHRISTOPHER HOOD, *EXPLAINING ECONOMIC POLICY REVERSALS* 5–7, 28–29 (1994).

76. DONALD N. McCLOSKEY, *THE RHETORIC OF ECONOMICS* 31 (1985).

77. See *id.*

different strands of institutionalism, whether cultural, historical, organizational, socio-legal, sociological, and a neo-institutional variant, mirror this diversity. The corollary is that gaining deep insight into the relevant structural and functional dimensions of the broad organizational architecture is a precondition for coming to grips with the intricacies of the regulatory process.<sup>78</sup>

The international side of the picture has been explored in a more selective and tentative fashion. As indicated, this pattern has its roots in a configuration characterized by domestic initiative and supranational fragility. The global aviation system is not atypical in this respect in that it is based on a negotiated order, and a bilateral one to boot. Three distinct approaches have emerged in this space: the Grenoble regulation school, the Parisian regulation school, and the American international regime school. They tend however to be preoccupied with level-of-analysis issues—productive system, nation State, or supranational entities—definitional matters, and structural and functional questions that are not firmly linked to theories of regulatory development. One notable exception to the norm is the recourse for explanatory purposes to the concepts of hegemonic power, exercised by the dominant nation State, and hegemonic stability associated with it. Both may shed light on the dynamics of regulation in the global economic arena and the modus operandi of players who inhabit it.<sup>79</sup>

The twin theories of hegemonic power and hegemonic stability provide a logical starting point for endeavoring to explain the evolution of Hong Kong's open skies strategy. The global aviation system can scarcely be portrayed as a level playing field. It has been unambiguously dominated by the United States during the entire modern era. It has also been remarkably stable overall at the macro level. Superior American economic power, reinforced by robust political leadership, has been a major source of cohesion, albeit in a form not necessarily universally welcome. U.S. aviation policies have not fluctuated widely because the underlying intellectual climate has undergone few material changes. Reformist ideas have exerted great influence at critical junctures, but there have been just two clearly discernible paradigm shifts since the early twentieth century. The Great Depression experience paved the way for Keynesian-style tight control of private enterprise and perceived

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78. See Noll, *supra* note 63, at 56–61; Baldwin, Scott, & Hood, *supra* note 63, at 11–13; BALDWIN & CAVE, *supra* note 62, at 27–31; MORGAN & YEUNG, *supra* note 63, at 53–59.

79. See Jean-François Vidal, *International Regimes*, in REGULATION THEORY: THE STATE OF THE ART 108, 108–14 (Robert Boyer & Yves Saillard eds., Carolyn Shread trans., Routledge 2002) (1995).

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interventionist excesses provoked a libertarian backlash culminating in the emergence of the deregulation movement in the late 1970's.

Stability should not be equated with a steady state. Gradual structural and functional transformation, falling short of a complete metamorphosis, has been a common feature of system adaptation. Force of ideas accounts may not elucidate it fully. Bernstein, for example, has resorted to life-cycle theory, predominantly of the private interest variety, in order to shed analytical light on the slow erosion of common good-oriented values in the face of capture-like pressures in the period extending from the 1930's to the 1950's. According to him, regulation inevitably progresses through the following stages: gestation (concerns with market failure lead to the creation of a regulatory agency), youth (the inexperienced regulatory agency is outmaneuvered by the regulatees but is sustained by a crusading zeal), maturity (political support for agency objectives diminishes and devitalization sets in; needs of industry begin to take precedence over those of the community), and old age (symptoms of atrophy proliferate and private interests become paramount).<sup>80</sup> Such microscopic changes however need not significantly detract from the stability of the system.

It may be argued that, in an environment dominated by a large and assertive hegemon, and one not susceptible to notable structural and functional shifts over the short term horizon, small and resource-poor, in the sense of not being able to effectively employ politico-economic leverage in the global arena, players like Hong Kong may not enjoy sufficient scope for displaying strategic initiative and may not have the incentive to do so, given the system's inherent stability. This may partly explain the territory's reactive posture regarding the open skies project. Opportunistic adaptation seems a more realistic option than active leadership in those circumstances. It would probably be unproductive—in light of the prevailing constraints, limited opportunities, and competing goals—to proactively pursue that otherwise apparently appealing liberal idea on a substantial geographic scale.

In recent years, a trend toward regionalization of the open skies blueprint has emerged because of the difficulties posed by a quantum leap beyond bilateralism at the global level, the Transatlantic Common Aviation Area plan is merely one manifestation of this phenomenon. Hong Kong could have thus exhibited greater initiative in the Asian

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80. See BERNSTEIN, *supra* note 72.

context. It is a moot point of course whether it would have been possible to leave the United States out of the regional picture as aviation challenges on that front are normally addressed in broader Asia-Pacific rather than narrower Asian terms. The hegemonic factor is again not entirely irrelevant here. Its explanatory power nevertheless is more modest and other conceptual schemes, taking into account the China shadow and domestic influences, may need to be relied upon for this purpose. After all, in both the global and regional domains, indeed, even the strictly bilateral ones, Hong Kong has displayed less individual and collective determination than New Zealand and Singapore, for example.

Public officials would doubtless claim, and not without certain justification, that they have been primarily seeking to serve the common good rather than passively adapting to stimuli originating from external sources. There are numerous conceptions of the public interest. Mitnick has identified a number of dimensions allowing to systematically classify them and has constructed a complex but workable typology on this basis.<sup>81</sup> In terms of some of the key criteria that he has suggested, the notion of the common good implicitly espoused by Hong Kong policy makers in this instance is probably combinatorial, there exist multiple sets of preferences for a course of action; the search for the public interest entails selecting a combination from those sets, a mixture of impositional and moderately consensual—instead of being the product of elaborate consensus building or pluralistic aggregation; impositional is more appropriate adjective than dictatorial because Hong Kong practices limited democracy which continues to be underpinned by British-style common law—and rule determined—the handful of participants involved in the process of effectively defining the public interest follow a set of well-defined procedures; the outcome is deemed to be consistent with the common good. To the extent that the consensual aspects reflect the general views of a specific group, such as economic researchers, engineering experts, and legal commentators, instead of the community-at-large, there may be scope for incorporating them in a less ambiguous fashion into the public interest equation.

Lawyers paint a largely favorable picture, albeit one that needs to be updated.<sup>82</sup> At the technical end of the analytical spectrum, scarcely any strategic assessments have been offered by members of the engineering profession, they may have been more active at the tactical and

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81. See MITNICK, *supra* note 63, at 264–74.

82. See Heilbronn, *The Changing Face of Hong Kong's International Air Transport Relations*, *supra* note 35; Heilbronn, *Hong Kong's First Bilateral Air Services Agreement: A Milestone in Air Law and an Exercise in Limited Sovereignty*, *supra* note 35; Heilbronn, *The Travel Industry*, *supra* note 35; ESSAYS ON AVIATION AND TRAVEL LAW IN HONG KONG, *supra* note 35.

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operational level, albeit not in public forums, but not necessarily from an overtly critical perspective. This may be construed as an indication of tacit approval. It should be noted however that legal scholars and practitioners who have addressed the subject in a rigorous fashion in the Hong Kong context have mostly confined themselves to the noneconomic facets of regulation.<sup>83</sup> This particular side of the topic has been explored by economists alone. Overall, they initially adopted a negative tone yet, as the regulatory regime has assumed a more flexible and sophisticated form, their observations have shifted in a generally positive direction.<sup>84</sup> The specific open skies component of the system has nevertheless remained a bone of contention, producing divergent responses.<sup>85</sup>

Those who provide their seal of qualified approval emphasize the seemingly distinctive features of the aviation industry. It is characterized by an undifferentiated product which is highly perishable, ease of entry, tendency toward monopoly or oligopoly, ease of entry notwithstanding, growth rate exceeding by a substantial margin that witnessed in many other industries, high capital intensity—which becomes more pronounced over time; labor intensity, on the other hand, diminishes—economies of scale/scope/density, network externalities, product externalities, strong locational influences, homogeneous production technology, greater-than-usual financial vulnerability, airlines often receive earlier-ordered aircraft/boost capacity before demand/traffic materializes on a corresponding scale, considerable sensitivity to changes in business cycle conditions, and elevated debt/equity ratios. Such features to all appearances selectively militate against fast-paced and far-reaching liberalization.<sup>86</sup>

From a public interest perspective, some economists have taken the position—broadly consistent with the loosely articulated government stance—that the aviation industry is of fundamental strategic importance for the highly open and resource-poor Hong Kong economy. The corollary is that its distinctive characteristics should loom large on the regulatory agenda and impart a degree of caution to decisions relating to market structure and conduct. This is particularly true with respect to issues at the heart of the open skies strategy such as the unilateral

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83. *See id.*

84. *See* Kai-sun Kwong, *The New Airport and Aviation in Hong Kong—A New Perspective* (Nov. 1990), available at <http://www.hku.hk/hkcer/articles/v5/rkwong.htm>.

85. *See* KWONG, *supra* note 51; Law & Yeung, *supra* note 51.

86. *See* O'CONNOR, *supra* note 3, at 5–7, 13–19, 22–23; Law & Yeung, *supra* note 51.

opening of the market and the one route-one airline configuration. The starting point in the multistep argument focuses on network and product externalities. Given the widespread reliance on hub-and-spoke facilities, an additional route confers external benefits on members of an existing network and new entrants, network externalities. By the same token, cargo and passenger services are complementary products in the aviation industry, product externalities. Airlines thus endeavor to enhance their performance by attaining an optimal mix of cargo and passengers via hub operations. In such an environment, rapid and wholesale liberalization could have a very uneven impact on existing market participants and new entrants. Uncertainty might rise significantly as a consequence, potentially eroding in the long run the strength of Hong Kong “designated” or “home” carriers and the territory’s status as a thriving aviation hub.<sup>87</sup>

The “home” carrier-aviation hub synergies are deemed to be considerable in this context. This stems from the fact that a healthy home carrier is the ideal vehicle for expanding the trunk routes and extending the air services network for the hub. Such an operator is a particularly valuable instrument for building cross-border airline and aviation alliances. Further, a strong home carrier, with headquarters located at its domestic base, has much more pronounced linkage and multiplier effects on the local economy than foreign operators. In addition, from a national security viewpoint, it can insure a stable supply of air services for the hub at delicate junctures (e.g., when external pressures in one form or another may bring about a disruption). Last but not least, a home carrier is a source of prestige for the hub, an admittedly intangible but by no means worthless politico-economic commodity, especially for a global metropolis lacking sovereign power and unambiguous identity.<sup>88</sup>

Another major claim put forth in support of the cautionary thesis is that both sequential and simultaneous liberalization of the cargo and passenger markets could prove problematic, albeit in different ways. These two markets are heterogeneous, but they employ a homogeneous production technology. The former is much less controlled by local carriers in Hong Kong than is the case elsewhere in Asia. It would be the first candidate for unilateral liberalization, if such a strategic shift materialized. The benefits would accrue to users of cargo services, yet passengers might be adversely affected. Moreover, the gains could prove transitory as a handful of foreign mega carriers might sooner or later emerge as the dominant players in the market. A unilateral opening of Hong Kong’s skies along the entire product spectrum could benefit certain classes of passengers (e.g., those flying economy) yet not others

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87. See Law & Yeung, *supra* note 51.

88. See *id.*



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(e.g., those flying business). It might also lead to deterioration in the operational efficiency and service quality of the home carriers.<sup>89</sup>

The seemingly controversial one route-one airline policy is portrayed in a similar vein. While it does not comfortably accord with the theory of contestable markets, practical experience generally vindicates it. Specifically, Australia, Canada, and the United Kingdom have followed the same path and their record suggests that effective competition between domestic airlines operating internationally can be maintained within this framework. Such a structural pattern may also be conducive to the development of a unified, as distinct from fragmented, aviation network. It is further asserted that the commercial performance of Cathay Pacific, the principal home carrier, has not been sufficiently exceptional to infer that the somewhat conservative approach, from a standard economic perspective, toward the evolving open skies platform has been materially shaped by other than public interest considerations.<sup>90</sup>

This view however is not universally shared across the professional spectrum and may be selectively challenged.<sup>91</sup> The home carrier-hub synergies, the likely fallout from unilateral liberalization, and the attractions of the one route-one airline policy appear to be overstated. The analysis seems to be tilted toward the producer side and may reflect greater concern for stability, perhaps understandably so in the uncertain Hong Kong political context, than other strategic values—including dynamic, as distinct from static, efficiency. The long-term benefits to consumers of a radical overhaul may not be accorded sufficient attention and different classes of customers (e.g., those flying economy versus those flying business) are treated equally. The possibility of realizing the advantages of far-reaching (albeit not necessarily fast-paced) liberalization, while largely avoiding the negative side-effects via innovative regulatory means not currently relied upon, is not seriously explored. The assumption that policy is inspired by perceptions of the common good, as well as underpinned by “correct” administrative procedures, need not be discarded, but additional theoretical insights are required.

Pressure group activity may not provide further illumination. Transportation is a vital and heavily politicized (by local standards)

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89. *See id.*

90. *See id.*

91. *See* KWONG, *supra* note 51.

sphere of economic activity in Hong Kong.<sup>92</sup> Politicization nevertheless seldom meaningfully extends beyond the road and rail segments of the sector. The air and water components, which impinge less decisively on the daily living of the grassroots community, have been subject to relatively modest bottom-up influences. The government has thus been able to proceed in a comparatively autonomous fashion and employ a predominantly managerial, as distinct from a political, which involves complex balancing, compromises, and tradeoffs, style. Decisions relating to strategic aviation issues cannot be described as merely the product of—externally-constrained, where appropriate—technical deliberations, sound or otherwise. They are imbued with political undertones, yet ones more consonant with the private interest and institutional theoretical perspectives.

Hong Kong has been portrayed, favorably for the most part, as a minimalist “State”.<sup>93</sup> This expression conjures up images of a detached Weberian-style bureaucracy mechanically performing a handful of Smithian-type functions absolutely essential to the smooth operations of the private market. Indeed, it was none other than Friedman, the founding father of modern monetarism and a prominent exponent of the Chicago School of economics, who has depicted the territory as the last bastion of the laissez-faire intellectual tradition and sympathetically likened it to a night-watchman State:

Hong Kong has no tariffs or other restraints on international trade. . . . It has no government direction of economic activity, no minimum wage laws, no fixing of prices. . . . Government plays an important, [but limited, role]. . . . It enforces law and order, provides a means for formulating the rules of conduct, adjudicates disputes, facilitates transportation and communication, and supervises the issuance of currency.<sup>94</sup>

Policy realities have never conformed fully to this stylized textbook portrait and the divergence has grown more pronounced over time, although not to a point rendering the portrait completely obsolete. The minimalist State has proved itself capable of succumbing to interventionist

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92. For an overview, see Rebecca Kwok, *Transport Policy, in THE HONG KONG SPECIAL ADMINISTRATIVE REGION IN ITS FIRST DECADE 729, 729–62* (Joseph Y. S. Cheng ed., 2007).

93. See MA NGOK, *POLITICAL DEVELOPMENT IN HONG KONG: STATE, POLITICAL SOCIETY AND CIVIL SOCIETY 17–21* (2007).

94. MILTON FRIEDMAN & ROSE D. FRIEDMAN, *FREE TO CHOOSE: A PERSONAL STATEMENT 33–34* (1981). See also G.B. ENDACOTT, *A HISTORY OF HONG KONG* (1964); ALVIN RABUSHKA, *THE CHANGING FACE OF HONG KONG: NEW DEPARTURES IN PUBLIC POLICY* (1973); ALVIN RABUSHKA, *VALUE FOR MONEY: THE HONG KONG BUDGETARY PROCESS* (1976); ALVIN RABUSHKA, *HONG KONG: A STUDY IN ECONOMIC FREEDOM* (1979); BRUCE BUENO DE MESQUITA, DAVID NEWMAN & ALVIN RABUSHKA, *FORECASTING POLITICAL EVENTS: THE FUTURE OF HONG KONG* (1985); BRUCE BUENO DE MESQUITA, DAVID NEWMAN & ALVIN RABUSHKA, *RED FLAG OVER HONG KONG* (1996).

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impulses and being drawn into the socio-political cauldron.<sup>95</sup> Moreover, its responses have not invariably followed a “neutral” path. The cultivated sense of bureaucratic detachment has always been something of an illusion as the administrative elite has chosen to ally itself closely with its business counterpart throughout the colonial era and beyond. This pattern has been carefully and credibly documented by Goodstadt, an astute observer of the Hong Kong politico-economic scene and a strategically-positioned government insider, former Head of the Central Policy Unit.<sup>96</sup> The picture he has painted suggests that the minimalist State has consistently displayed strong corporatist tendencies.<sup>97</sup>

The decisive and wholesale liberalization of the telecommunications sector is often cited as an example of bureaucratic distance from business and willingness to undertake structural reforms costly for entrenched corporate interests. As a consequence of this strategic initiative, a distinctly monopolistic configuration has given way to an unambiguously fragmented one. Consumers have reaped the benefits in terms of product diversity, price, and quality. Such examples however are few and far between. In some key industries, the minimalist State has been content to countenance, and even encourage, a high concentration of market power and uncompetitive practices.<sup>98</sup> Moreover, the circumstances which precipitated the revamping were somewhat unique from a political perspective<sup>99</sup> and the status quo was becoming technologically untenable.<sup>100</sup> The persistent reluctance to contemplate, until recently, a

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95. See MA, *supra* note 93, at 21–31. See also T.Y. CHENG, *THE ECONOMY OF HONG KONG* (1982); A.J. YOUNGSON, *HONG KONG: ECONOMIC GROWTH AND POLICY* (1982); GAVIN PEEBLES, *HONG KONG'S ECONOMY: AN INTRODUCTORY MACROECONOMIC ANALYSIS* (1988); *MANAGING THE NEW HONG KONG ECONOMY* 1–17 (David Mole ed., 1996); Edward K.Y. Chen, *The Economic Setting*, in *THE BUSINESS ENVIRONMENT IN HONG KONG* 3–46 (David G. Lethbridge & Ng Sek Hong eds., 4th ed, 2000).

96. See LEO F. GOODSTADT, *UNEASY PARTNERS: THE CONFLICT BETWEEN PUBLIC INTEREST AND PRIVATE PROFIT IN HONG KONG* (2005). See also Mole, *Introduction*, in *MANAGING THE NEW HONG KONG ECONOMY*, *supra* note 95.

97. See sources cited *supra* note 96.

98. See GOODSTADT, *supra* note 96, at 4–5, 67–80, 117–138; Mushkat & Mushkat, *supra* note 1.

99. See GOODSTADT, *supra* note 96, at 4–5, 67–68.

100. For an overview, see MILTON MUELLER, *INTERNATIONAL TELECOMMUNICATIONS IN HONG KONG: THE CASE FOR LIBERALIZATION* (2d ed. 1992); *TELECOMMUNICATIONS IN THE ASIA PACIFIC BASIN: AN EVOLUTIONARY APPROACH* (Eli Noam, Seisuke Komatsuzaki & Douglas A. Conn eds., 1994); *TELECOMMUNICATIONS IN ASIA: POLICY, PLANNING AND DEVELOPMENT* (John Ure ed., 1995); Xu Yan & Douglas C. Pitt, *One Country, Two Systems: Contrasting Approaches to Telecommunications Deregulation in Hong Kong China*, 23 *TELECOMM. POL'Y* 245, 245–60 (1999); *DEREGULATION AND*

modern-style competition law is indicative of an enduring determination to preserve a modicum of big business privileges.<sup>101</sup>

Trends in the aviation domain have not materially deviated from this pattern. The colonial regime had exhibited an unmistakable bias in favor of British Airways (BA), perhaps under subtle pressure from London, and it had otherwise been gently protective of the home carrier (Cathay Pacific).<sup>102</sup> It is apparent that its post-1997 counterpart has gone to considerable lengths not to erode the latter's margin of advantage.<sup>103</sup> This may not amount to a full-scale, Chicago-type capture, and the strategy may even include an element of the public interest, however defined. Yet, it is a reflection of a deliberate corporatist orientation, which has deep historical roots and manifests itself in a number of pivotal spheres of economic activity. A unilateral opening of Hong Kong's skies and parallel initiatives could prove highly disruptive for the generally profitable and stable home carrier, far more so than for the hub, from a long-term perspective. That doubtlessly is an additional factor in the complex regulatory equation.

A host of institutional influences may also impinge on decisions relating to the open skies platform, some possibly in a meaningful fashion. It should thus be noted that a minimalist State is not necessarily a reformist one. An innate conservatism, coupled with a strong penchant for not tinkering with time-honored simple rules governing organizational behavior, tends to breed a degree of strategic inertia. The powerful deregulation tide in the latter part of the twentieth century had its origins in maximalist settings (e.g., Australia, Canada, New Zealand, United Kingdom, and the United States) even though it was triggered by forces selectively driven by minimalist values. The Hong Kong bureaucracy has been traditionally content to adopt a passive posture and respond to impulses emanating from other segments of the politico-economic and

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INTERDEPENDENCE IN THE ASIA-PACIFIC REGION (Takatoshi Ito & Anne O. Krueger eds., 2000); TELECOMMUNICATIONS AND DEVELOPMENT IN ASIA (John Ure ed., 2008).

101. See GOODSTADT, *supra* note 96, at 4–5; John H. Ho, *From Free Port to Competition: Is Asia's World City Playing Catch-up?*, in THE HONG KONG SPECIAL ADMINISTRATIVE REGION IN ITS FIRST DECADE 421–42, *supra* note 92; LEONARD K. CHENG & CHANGQI WU, *COMPETITION POLICY AND THE REGULATION OF BUSINESS* (1998); Edward K.Y. Chen & Ping Lin, *Competition Policy under Laissez-Faireism: Market Power and its Treatment in Hong Kong*, 21 REV. OF INDUS. ORG. 145, 145–66 (2002); Suk-Ching Ho & Chi-Fai Chan, *In Search of a Competition Policy in a Competitive Economy: The Case of Hong Kong*, 37 J. OF CONSUMER AFF. 68–85 (2003); TONY LATTER, *HANDS ON OR HANDS OFF? THE NATURE AND PROCESS OF ECONOMIC POLICY IN HONG KONG* 91–100 (2007).

102. See GOODSTADT, *supra* note 96, at 68–69.

103. See Law & Yeung, *supra* note 51. For additional insights, see NG SEK HONG & CAROLYN Y.W. POON, *BUSINESS RESTRUCTURING IN HONG KONG: STRENGTHS AND LIMITS OF POST-INDUSTRIAL CAPITALISM* 49–76 (2004).

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socio-political arenas, predominantly relying on outside rather than inside initiation.<sup>104</sup>

Moreover, its receptivity to external signals, a concept featuring in regulatory theory, may be portrayed as limited. The governmental decision-making machinery is supported by an extensive network of advisory committees with substantial scope for private sector participation, but not leadership. In addition, independent consultants are employed in order to provide strategic or tactical illuminations. The selection process however is closely controlled by the bureaucracy and so is the working agenda, particularly at the strategic level.<sup>105</sup> The Hong Kong Center for Economic Research, a libertarian organization drawing its intellectual inspiration from Chicago sources, has been issuing analytical reports advocating radical liberalization across wide swathes of industrial activity, including air transportation which do not overlook the open skies issue.<sup>106</sup> However, these reports have seldom provoked a serious official reaction, and that cannot be attributed just to the overly academic packaging.

Another institutional factor which may be relevant in this context is regulatory goal deflection stemming from organization-specific structural influences, with functional ramifications, rather than economic pressures (i.e., cartelization, capture, and individual versus collective utility-maximization). In Anglo-Saxon jurisdictions, particularly the United States, lawyers often constitute the key professional element in regulatory agencies. By virtue of their training and experience, and consequently values and priorities set, they tend to place greater emphasis on process-focused objectives than outcome-oriented ones.<sup>107</sup> Goal deflection is the upshot. A similar phenomenon may be observed in Hong Kong, where generalists, referred to as administrative officers, dominate the top layers of the bureaucratic pyramid. They display lawyer-like qualities and, for better or for worse, their modus operandi may slow the wheels of the

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104. See Miron Mushkat & Roda Mushkat, *The Political Economy of Loose Regulation: Modernity Meets Tradition in Hong Kong*, 7 INT'L J. OF REG. & GOVERNANCE 101, 101–46 (2007).

105. For an overview, see MA, *supra* note 93; JOHN P. BURNS, GOVERNMENT CAPACITY AND THE HONG KONG CIVIL SERVICE (2004); IAN SCOTT, PUBLIC ADMINISTRATION IN HONG KONG: REGIME CHANGE AND ITS IMPACT ON THE PUBLIC SECTOR (2005); CONTEMPORARY HONG KONG POLITICS: GOVERNANCE IN THE POST-1997 ERA (Lam Wai-man et al. eds., 2007).

106. See KWONG, *supra* note 51.

107. See Roger G. Noll, *Introduction*, in REGULATORY POLICY AND THE SOCIAL SCIENCES, *supra* note 62, at 28–33.

regulatory engine.<sup>108</sup> Interestingly, in “Communist” China too, generalists have traditionally dictated policy direction, with technocrats gaining ascendancy when decisive problem management has been required.<sup>109</sup>

It may be further argued that the post-1997 institutional environment is not conducive to regulatory innovation, particularly in policy domains involving relations with foreign jurisdictions. The transition from British to Chinese rule may have not been abrupt, but the local bureaucracy, apparently somewhat inward-looking and static in its attitudinal disposition, may have not been sufficiently prepared and adequately equipped to effectively confront the external challenges likely to emerge within the politically more complex “One Country, Two Systems,” or “Greater China, organizational framework. The gap between strategic expectations embedded in the new reality, or the sheer magnitude of the task facing the post-1997 policy makers, and institutional capabilities may have induced a degree of caution, or a systematic preference for risk avoidance rather than risk taking.”<sup>110</sup> The lack of strategic predictability and transparency on the Chinese side<sup>111</sup> may have compounded the uncertainty and may have reinforced the conservative bias.<sup>112</sup>

This theme has been brought into sharp focus by one of Hong Kong’s leading political scientists. In a series of trenchant studies, he has highlighted the growing institutional convergence between the territory and China.<sup>113</sup> Other researchers have focused on the increasing economic integration, particularly in the Pearl River Delta context, and the positive spillovers accruing to the two parties, without suggesting that a marked

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108. For an overview, see Burns, *supra* note 105; Scott, *supra* note 105; MIRON MUSHKAT, *THE MAKING OF THE HONG KONG ADMINISTRATIVE CLASS* (1982); *THE HONG KONG CIVIL SERVICE: PERSONNEL POLICIES AND PRACTICES* (Ian Scott & John P. Burns eds., 1984); *THE HONG KONG CIVIL SERVICE AND ITS FUTURE* (Ian Scott & John P. Burns eds., 1988); *HONG KONG IN TRANSITION: THE HANDOVER YEARS* (Robert Ash et al. eds., 2000).

109. For an overview, see VICTOR C. SHIH, *FACTIONS AND FINANCE IN CHINA: ELITE CONFLICT AND INFLATION* (2008).

110. See Mushkat, *Hong Kong’s Exercise of External Autonomy: A Multi-Faceted Appraisal*, *supra* note 33.

111. For an overview, see KENNETH LIEBERTHAL & MICHEL OKSENBURG, *POLICY MAKING IN CHINA: LEADERS, STRUCTURES, AND PROCESSES* (1988); HUANG JIANRONG, *THE APPLICABILITY OF POLICY-MAKING THEORIES IN POST-MAO CHINA* (1999); *THE MAKING OF CHINESE FOREIGN AND SECURITY POLICY IN THE ERA OF REFORM* (David M. Lampton ed., 2001); SUSAN L. SHIRK, *CHINA: FRAGILE SUPERPOWER* (2007).

112. See Mushkat, *Hong Kong’s Exercise of External Autonomy: A Multi-Faceted Appraisal*, *supra* note 33.

113. See Sonny Shiu-Hing Lo, *The Mainlandization and Recolonization of Hong Kong: A Triumph of Convergence over Divergence with Mainland China*, in *THE HONG KONG SPECIAL ADMINISTRATIVE REGION IN ITS FIRST DECADE*, *supra* note 92, at 179–231; SONNY SHIU-HING LO, *GOVERNING HONG KONG: LEGITIMACY, COMMUNICATION AND POLITICAL DECAY* (2002); SONNY SHIU-HING LO, *THE DYNAMICS OF BEIJING-HONG KONG RELATIONS: A MODEL FOR TAIWAN* (2008).

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(as distinct from modest) erosion of autonomy has taken place, thus leaving the local organizational façade largely intact. By contrast, Lo has likened the whole process to one of mainlandization and recolonization. According to him, Hong Kong has become economically dependent on China and deferential toward the central government in key spheres of socio-political activity. This has inevitably affected its institutional landscape, both structurally and functionally.<sup>114</sup> One does not need to assume that the thesis is fully valid to conclude that regulatory innovation in an area impinging on mainland interests, including those of its budding airlines, and having global or regional ramifications, would be perceived as a risky enterprise by local policy makers.

This trend, whether firmly grounded in organizational reality or somewhat overstated, may have implications for strategic initiatives falling short of complete liberalization. There is some scope, for example, for enhancing Asian cooperation without direct American participation. This reflects the fact that the bilateral accords between countries in the region and the United States are generally more progressive than those among themselves. The reluctance to liberalize them even further by granting, for instance, unlimited Seventh Freedom rights or change of gauge rights to American carriers apparently stems from the belief that this might pave the way for their domination of Asian aviation markets. In such circumstances, it would be logical for countries in the region, particularly those enjoying substantial locational advantages, to solidify mutual commercial relationships and forge more progressive agreements. This could boost the competitiveness of Asian airlines.<sup>115</sup> Hong Kong might be expected, in a low-key fashion if necessary, to take the first steps in that direction but, rather typically from a post-1997 perspective,<sup>116</sup> has thus far refrained from pursuing the less ambitious regional cooperation option.

Cross-border institutional convergence, whose degree cannot be reliably ascertained, has coincided with additional cohesion-sapping developments in the political environment in which the regulatory machinery is embedded. Progress has nevertheless been transformed as the legislature, fledgling parties, pressure groups, and civil society—including the vociferous media—have gained greater prominence, which

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114. See sources cited *supra* note 113.

115. See Law & Yeung, *supra* note 51.

116. See Mushkat, *Hong Kong's Exercise of External Autonomy: A Multi-Faceted Appraisal*, *supra* note 33.

should not be necessarily equated with tangible influence. Executive-led government remains entrenched, yet in a political setting characterized by growing checks and balances, and where the exercise of executive power has evolved into a far more challenging undertaking than in the heyday of the colonial era.<sup>117</sup> This has been accompanied by increasing institutional fragmentation. Indeed, it has been noted that the political system has become “disarticulated”. Specifically, given that the entire structure amounts to “neither parliamentary fish nor presidential fowl, the executive, the bureaucracy and the legislature (which is divided within itself) each pursue their own agendas, punctuated by occasional skirmishes on the boundaries of their domains and by subterranean campaigns to extend their jurisdictions.”<sup>118</sup>

The colonial era had witnessed at least three “crises of legitimacy”, although their degree is equally difficult to reliably ascertain. However, they proved relatively short-lived and containing them had not posed a formidable problem.<sup>119</sup> The crisis of legitimacy stemming from the transition from British to Chinese rule has been more prolonged and less amenable to strategies of containment. Government performance has also deteriorated during the post-1997 period and Chinese actions have at times undermined local confidence.<sup>120</sup> This has resulted in a persistent erosion of trust in the policy machinery, reinforcing the adverse effects of institutional fragmentation.<sup>121</sup> In such a fragile organizational setting, regulatory quantum leaps in general, other than in special local circumstances, and with respect to the open skies platform in particular may be well beyond the realm of feasibility. Influences of this nature ought arguably to be taken into consideration when dissecting the global legal architecture.

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117. For an overview, see HONG KONG IN TRANSITION: THE HANDOVER YEARS, *supra* note 108; THE HONG KONG SPECIAL ADMINISTRATIVE REGION IN ITS FIRST DECADE, *supra* note 92; CONTEMPORARY HONG KONG POLITICS: GOVERNANCE IN THE POST-1997 ERA, *supra* note 105; MA, *supra* note 93; INSTITUTIONAL CHANGE AND THE POLITICAL TRANSITION IN HONG KONG (Ian Scott ed., 1998).

118. Ian Scott, *The Disarticulation of Hong Kong's Post-Handover Political System*, 43 CHINA J. 29, 29–53 (2000).

119. For an overview, see IAN SCOTT, POLITICAL CHANGE AND THE CRISIS OF LEGITIMACY IN HONG KONG (1989).

120. See Miron Mushkat & Roda Mushkat, *Political Economy of Governance and Public Trust: The Promise of Autonomy and Post-1997 Hong Kong Inertia*, 37 INTERNATIONALES ASIENFORUM: INT'L Q. FOR ASIA STUD. 87, 87–117 (2006).

121. See Timothy Ka-ying Wong & Shirley Po-san Wan, “Citizens’ Evaluations of Legitimacy in Post-Colonial Hong Kong: Results of a Longitudinal Study”, in THE HONG KONG SPECIAL ADMINISTRATIVE REGION IN ITS FIRST DECADE, *supra* note 92, at 75–107.



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## V. IMPLICATIONS FOR INTERNATIONAL REGIMES

The fact versus value controversy is a tip of the slippery analytical iceberg. Underlying it are intense disagreements between members of different schools of thought (e.g., objectivists and subjectivists, realists and constructivists) as to what qualifies as true or false and good or evil. Neither the law nor the social sciences can avoid this intellectually treacherous territory—indeed, it would be inappropriate for researchers operating in those academic domains to bypass that uncomfortable terrain in a cavalier fashion. For practical purposes, it may nevertheless be convenient, or even legitimate, to assume that the two intertwined concepts can be clinically uncoupled in order to exclusively focus on one or the other. This Article is thus not without sympathy for the libertarian vision from which Hong Kong is assumed to draw its inspiration (albeit not unambiguously) but its principal purpose is to provide an empirically-based explanation rather than engage in strict normative evaluation.

Factually-driven analytical accounts may not be the mainstay of traditional legal scholarship and the “hard” social sciences, yet they can scarcely be portrayed as a peripheral phenomenon. The picture varies from one academic sub-discipline to another, but such accounts feature prominently in the fields of contemporary international law and international political economy, to the extent that international law and international relations overlap, the latter has long displayed a strong empirical and analytical orientation. Rather than treating this explanatory survey as a stand-alone case study, it may thus be desirable to place the findings in a broader theoretical context. The open skies platform, while loosely structured, has the attributes of a legal regime or international legal regime,<sup>122</sup> a factually-grounded analytical construct. The corollary is that the Hong Kong experience in that respect may furnish additional insights into a concept whose empirical roots do not materially extend beyond American and European territory.

Its loose structure notwithstanding, the open skies platform occupies a relatively high place in the hierarchy of international regimes. It is a diverse platform with weak multilateral underpinnings. Some of its components have not evolved beyond the constellation that prevailed

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122. A regime is a set of “implicit or explicit principles, norms, rules, and decision making procedures around which actors’ expectations converge in a given [issue-area].” Stephen D. Krasner, *Structural Causes and Regimes Consequences: Regimes as Intervening Variables*, in INTERNATIONAL REGIMES 2 (Stephen D. Krasner ed., 1983).

prior to the partial deregulation of the international aviation industry and others have by no means seen exponential progress. Yet, it is a formal legal platform governed by explicit sovereign, or equivalent, commitments, even if predominantly bilateral in nature. It does not just substantively differ from regimes which are anchored in implicit undertakings, often possessing significant practical ramifications, but can be said to be technically “superior” (without necessarily being “better”) to them. The implication is that Hong Kong’s adaptation to this moving platform may shed further theoretical light on the functioning of international legal regimes rather than merely forms of patterned interstate behavior, which in itself should not be automatically equated with customary international law.<sup>123</sup>

Such formal systems and their informal counterparts are multidimensional entities. Legal researchers and social scientists have principally focused on two facets: regime origins and persistence. Their ideas have followed three theoretically divergent paths: realist/neorealist, liberal/neoliberal, and cognitivist. They do however loosely share at least one common crucial assumption: their work is based on the fundamental premise that international regimes are an essentially effective antidote to international anarchy. The analytical gap between the realist and liberal conceptual schemes is less wide than that separating them and the cognitivist edifice, the latter is an academically well established school of thought, and it would thus be inappropriate to portray it as nonmainstream, but it is of a relatively recent vintage and its policy impact has been distinctly more modest.

State power looms large in realist discourse and, importantly in this context, so do its unequal distribution and ramifications thereof for system performance. International regimes are thought to be dominated by a single hegemon who acts as a stabilizing force by displaying specific commitments and deploying relevant capabilities. The resulting configuration remains intact, hence hegemonic stability, even in the face of selective free riding by other participants—as long as there are no marked shifts in the distribution of State power and the hegemon does not retreat into indifference or negativism.<sup>124</sup> Realist-style regimes may

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123. See JACK L. GOLDSMITH & ERIC A. POSNER, *THE LIMITS OF INTERNATIONAL LAW* 23-26 (2005).

124. For an overview, see Stephen D. Krasner, *State Power and the Structure of International Trade*, 28 *WORLD POL.* 317, 317-47 (1976); ROBERT GILPIN, *WAR AND CHANGE IN WORLD POLITICS* (1981); Charles P. Kindleberger, *Dominance and Leadership in the International Economy: Exploitation, Public Goods, and Free Rides*, 25 *INT’L STUD. Q.* 242, 242-52 (1981); CHARLES P. KINDLEBERGER, *THE WORLD IN DEPRESSION, 1929-1939* (2d ed. 1986); Michael C. Webb & Stephen D. Krasner, *Hegemonic Stability Theory: An Empirical Assessment*, 15 *REV. OF INT’L STUD.* 183, 183-98 (1989).

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encompass a wide range of patterned interstate behavior, exhibiting characteristics which are accorded considerable attention in contemporary theories of international law, such as coincidence of interest, coordination, cooperation, and coercion.<sup>125</sup>

A noteworthy feature of the realist conception is the assumption that States are highly sensitive to relative gains or losses. Specifically, they go to great lengths to insure that, subject to any meaningful constraints stemming from disparities in State capabilities to affect outcomes, other parties do not obtain more from an agreement than they do. Cooperation is thus more likely to materialize in situations where a broadly equitable course can be readily followed. In practice, this is typically the case in the economic domain, because pursuing rough symmetry may not be a practical option in the military realm, given the prevalence of hegemonic limitations, irrespective of whether the hegemon is “benevolent” or “malevolent”, although this is obviously a relevant factor.<sup>126</sup> However, even in the economic sphere, State power may be a key determinant of the actual shape of the bilateral or multilateral accord.<sup>127</sup>

In terms of behavioral range, liberals cast their analytical net less wide than realists. As befitting the intellectual successors to idealists, they primarily focus on cooperation, which they distinguish from harmony and discord.<sup>128</sup> Collaborative interaction is rooted in State interdependence rather than State dominance. The presence of a hegemon is not a necessary condition for regime formation and persistence. Power is not a decisive element in the overall equation. It neither definitively shapes State preferences nor exclusively determines regime evolution. Even if they do not conform to the supposedly stability-enhancing unipolar pattern, international regimes generate concrete benefits for members

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125. See GOLDSMITH & POSNER, *supra* note 123, at 10–14, 27–35, 84–91.

126. For an overview, see Joseph M. Grieco, *Anarchy and the Limits of Cooperation: A Realist Critique and the Newest Liberal Institutionalism*, 42 INT'L ORG. 485, 485–507 (1988); JOSEPH M. GRIECO, COOPERATION AMONG NATIONS: EUROPE, AMERICA, AND NON-TARIFF BARRIERS TO TRADE (1990); Joseph M. Grieco et al., *The Relative-Gains Problem for International Cooperation*, 87 AM. POL. SCI. REV. 729, 729–35 (1993); Joseph M. Grieco, *Understanding the Problem of International Cooperation: the Limits of Neoliberal Institutionalism and the Future of Realist Theory*, in NEOREALISM AND NEOLIBERALISM: THE CONTEMPORARY DEBATE 301, 301–39 (David A. Baldwin ed., 1993).

127. See Stephen D. Krasner, *Global Communications and National Power: Life on the Pareto Frontier*, 43 WORLD POL. 336, 336–66 (1991).

128. For an overview, see ROBERT O. KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY (1984).

(e.g., they crystallize expectations regarding interstate behavior, lower transaction costs, furnish valuable information with respect to actions of other participants, reduce uncertainty, and solidify external linkages), thus fostering a cooperative spirit.<sup>129</sup>

Liberals express misgivings about the modeling of international reality along the lines of the classic single-round, two-person prisoner's dilemma game, in which the payoff structure renders defection a dominant strategy for both players, arguing that realists implicitly follow this methodological path. According to them, behavioral responses in one-off situations should not serve as a basis for drawing inferences concerning interstate relations, which need to be sustained over long periods of time. The iterated prisoner's dilemma game is a more effective analytical tool for explaining sequential decision making under uncertainty in dynamic international settings. In such circumstances, it is rational for States to cooperate in the present in order to prevent other States from defecting in the future (i.e., pursue a tit-for-tat strategy) and to focus on absolute—as distinct from relative—gains from collaboration.<sup>130</sup>

The State is the principal focus of theoretical attention in both realist and liberal accounts of international regime development, although the latter offers greater scope for incorporating non-State actors into the conceptual framework. While they are not always made unambiguously explicit, State goals obviously diverge rather than converge in realist and liberal explanatory schemes. At the same time, the State is viewed from the two perspectives not merely as an autonomous, purposeful, and unitary entity but also as an entirely rational one. This is consistent with contemporary international legal theories which obtain their inspiration from microeconomics, without unequivocally embracing methodological individualism. Such theories posit that, like corporations, States may be regarded as agents with a clear identity, cohesive structure, well-defined preferences and instrumental orientation.<sup>131</sup>

Several branches of the law have an increasingly productive conceptual relationship with economics, albeit a largely one-sided in nature. International legal theory, even of a contemporary vintage, continues to veer more strongly toward other behavioral sciences such as political sociology. The prominent New Haven-Yale school of international law thus places a heavy emphasis on social choice processes relied upon in pursuing community well-being, jurisprudential goals. In recent years,

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129. For an overview, see *id.*

130. For an overview, see *id.*; ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* (1984); Robert Axelrod & Robert O. Keohane, *Achieving Cooperation under Hierarchy: Strategies and Institutions*, 38 *WORLD POL.* 226, 226–54 (1985); *COOPERATION UNDER ANARCHY* (Kenneth A. Oye ed., 1986).

131. See GOLDSMITH & POSNER, *supra* note 123, at 4–10.

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its exponents have resolutely challenged the State-focused, nationalist model embraced by economically-minded legal researchers (i.e., the assumption that “international law emerges from States’ pursuit of self-centered policies on the international stage”).<sup>132</sup> They have consistently painted a highly pluralistic picture of the global legal landscape<sup>133</sup> featuring a host of significant non-State actors and powerful bottom-up, as distinct from top-down, State-driven forces.<sup>134</sup>

Cognitivism, a variant or an extension of constructivism, which posits that, although a real world exists, it does not possess an inherent meaning, has sociological underpinnings too, albeit ones of the micro rather than macro variety, social-psychology versus political sociology. Its conception of international regimes reflects the belief that agents or States engage in action in a social as well as a material setting and that this setting provides them with an understanding of their interests. The corollary is that agents or States are not necessarily rational players, that they cannot be isolated in a positivist fashion from their socio-political environment for analytical purposes, that perceptions of interest and power matter, that such perceptions are not static, that different constructions of interest and power are a common phenomenon, and that iteration—both in game-like situations and the real world—is accompanied by learning (i.e., that agents or States do not merely discount the future but draw lessons from the past and respond accordingly).<sup>135</sup>

Subjectivity, or inter-subjectivity, is thus a key component of cognitivist regime theories. The emphasis is on the acquisition of contextual and differential meaning via the performance of roles in complex and

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132. *Id.*

133. For an overview, see Paul Schiff Berman, *A Pluralist Approach to International Law*, 32 YALE J. INT'L L. 301, 301–29 (2007). See also ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* (2004).

134. For an overview, see Janet Koven Levit, *Bottom-Up International Law Making: Reflections on the New Haven School of International Law*, 32 YALE J. INT'L L. 393, 393–420 (2007). See also SLAUGHTER, *supra* note 133.

135. For an overview, see NEOREALISM AND ITS CRITICS (Robert O. Keohane ed., 1986); FRIEDRICH V. KRATOCHWIL, RULES, NORMS, AND DECISIONS: ON THE CONDITIONS OF PRACTICAL AND LEGAL REASONING IN INTERNATIONAL RELATIONS AND DOMESTIC AFFAIRS (1989); Peter M. Haas, *Introduction: Epistemic Communities and International Policy Coordination*, 46 INT'L ORG. 1, 1–35 (1992); IDEAS AND FOREIGN POLICY: BELIEFS, INSTITUTIONS AND POLITICAL CHANGE (Judith Goldstein & Robert O. Keohane eds., 1993); Alexander Wendt, *Constructing International Politics*, 20 INT'L SECURITY 71, 71–81 (1995); ANDREAS HASENCLEVER, PETER MAYER & VOLKER RITTBERGER, THEORIES OF INTERNATIONAL REGIMES (1997); ALEXANDER WENDT, SOCIAL THEORY OF INTERNATIONAL POLITICS (1999).

dynamic social settings. The ideas that crystallize in such circumstances exert a strong influence on agents' or States' behavioral trajectories and, by implication, regime evolution, as shown in Table 4. It follows that idea formation, selection, dissemination, and implementation are crucial processes that ought to loom large on the international law/relations research agenda, hence the focus on epistemic communities which generate, prioritize, share, and promote policy ideas. Regimes also shape agents' or States' perceptions of international reality, including their own derived identities, and provide them with cues regarding acceptable, desirable, or legitimate modes of international conduct (i.e., they have constitutive, as well as regulative, effects).<sup>136</sup>

TABLE 4  
THEORETICAL PERSPECTIVES ON  
INTERNATIONAL REGIMES

	REALISM	LIBERALISM	COGNITIVISM
CENTRAL VARIABLE	Power	Interests	Knowledge
METATHEORETICAL ORIENTATION	Rationalist	Rationalist	Sociological
BEHAVIORAL MODEL	Relative gains seeker	Absolute gains maximizer	Role player
INSTITUTIONALISM	Weak	Medium	Strong

Adapted from Hasenclever, Mayer, and Rittberger, *op.cit.*, p. 6.

A number of potentially useful observations may be offered with respect to the three competing conceptual schemes, as well as related theoretical constructs, outlined above in light of Hong Kong's open skies experience. First, no single analytical framework may claim universal validity; their relevance apparently varies from one issue-area to another and one set of structural conditions to another (i.e., achieving situational validity may be a less ambitious, but more appropriate, objective for their proponents); as matters stand, attempts to design an overarching conceptual scheme may prove unproductive, particularly since the scope for systematically integrating individual international regime theories seems limited.<sup>137</sup> Second, even if taken together and augmented by

136. For an overview, see sources cited *supra* note 135.

137. Cf. John A.C. Conybeare, *Air Wars: Regulation and Deregulation in the International Air Passenger Market*, 6 POL'Y STUD. REV. 425, 425-38 (1987); John E.

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incorporating complementary mainstream perspectives, the three analytical frameworks do not provide a sufficiently comprehensive foundation for exploring patterned interstate behavior; domestically-oriented, and thus non-mainstream from a broader viewpoint conceptual schemes focused on the regulatory function may shed further light on the functioning of international legal regimes such as the open skies platform. Third, theory construction must not be exclusively based on samples or case studies heavily skewed toward the United States or Europe and the analytical effort should be extended across the entire geographic spectrum; the inclusion of cases not readily conforming to the “dominant” politico-economic and socio-political model may turn out to be an especially beneficial step.

Interestingly, the realist school, the oldest and least fashionable of the three, paints a picture most consistent with the specific empirical trends identified in this paper. The open skies regime has displayed hegemonic characteristics throughout most of its history and its relatively high degree of stability may be legitimately attributed to hegemonic influences. By the same token, the principle of reciprocity, envisioning relative rather than absolute agent or State gains, lies at the heart of the system, both in the normative and practical sense of the term. As an economically active, but politically marginal, member of the regime, Hong Kong has opted for a strategy of opportunistic adaptation, largely following an exogenously charted course whose features have been more or less determined in hegemonic headquarters. Unlike in many other similar domains (e.g., trade in goods and most services, foreign investment), the territory has not sought absolute gains, which could have conceivably resulted in the long run from unilateral opening of its skies, and has consistently, even rigidly, adhered to the relativist formula.

The State has clearly played a pivotal role in the process. This again conforms to realist portrayals of international regime dynamics, without diverging from liberal and economically-inspired nationalist, in contemporary international law, ones. Subject to the qualification that the adjective has no precise empirical meaning, and taking prevailing domestic and external constraints into consideration, there is no reason to suggest that State actions have been not predominantly rational on the open skies front. Once more, this is not at variance with realist, as well as liberal

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Richards, *Toward a Positive Theory of International Institutions: Regulating International Aviation Markets*, 53 INT'L ORG. 1, 1-37 (1999).

and economically-inspired nationalist, predictions. Elsewhere, notably in American hegemonic territory, there may have been strong pluralist-style bottom-up forces at work, although as a whole the open skies regime seems to be characterized by a relatively low degree of institutional fragmentation. Yet, this has not been the case in Hong Kong, and presumably in many other jurisdictions, Singapore being an obvious example.

That said, the realist model does not fit the empirical facts in all respects. The open skies regime has matured considerably and no longer depends critically on a single hegemon for its survival. From a structural perspective, it currently resembles a loose duopoly, with the European community serving as an economic counterweight to the United States. Liberal-type conceptions of cooperation, possibly reinforced by some cognitivist influences, may be contributing to its persistence, indeed, steady quantitative and qualitative expansion. Within this institutional framework, Hong Kong enjoys a growing room for maneuver, particularly if China is removed from the equation for analytical purposes, and, in terms of policy content, has forged moderately diversified commercial relations with a substantial number of “partners” across the globe. A higher degree of diversity could have been achieved, had it not been for a self-imposed strategic restraint.

Moreover, the pivotal role played by the State should not be equated with an exclusive one. The unitary realist construct does not accord even with the mildly differentiated Hong Kong institutional landscape, let alone with genuinely pluralist ones. The same obviously holds true for its liberal and economically-inspired/nationalist counterparts. The territory’s political system may be executive led, but it is not rigidly top-down driven. As pointed out, a close partnership between government and business has been a key hallmark of the local institutional environment since the inception of the colonial era to the present. Like the current open skies regime, the overall pattern is structurally similar to a market duopoly. The concept of State interest, supposedly pursued in a determined fashion by political agents, is thus distinctly ambiguous. The issue of “whose interest” is being sought can not be conveniently overlooked, other than for purposes of conducting controlled analytical experiments. This is selectively acknowledged in the liberal and economically-inspired nationalist literature but not explored as thoroughly as in domestically-oriented writings on regulatory behavior.

On the face of it, cognitivism appears to be the product of theoretical over-specification: too many esoteric variables substantially imported from developmental psychology are potentially brought to bear with excessive precision on a problem involving an essentially businesslike government which grapples with concrete challenges in a seemingly



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practical manner. This school of thought however is not irrelevant in this context. Ideas, as distinct from power and interests, have clearly been a key factor in shaping the evolution of the open skies regime, particularly at decisive turning points. Whether or not they can be meaningfully decoupled from power and interests, ideas have considerable explanatory value and merit close scholarly attention. To their credit, cognitivists have approached this task methodically and have tentatively identified social mechanisms facilitating idea formation, selection, sharing, and promotion. With reference to Hong Kong, the question relates to the impediments to the flow of locally well-entrenched liberatarian ideas pertaining to the open skies platform. As argued here, the answer partly lies in the institutional domain, although cognitivist-style probing may yield additional insights.

According to liberals and cognitivists, institutions matter. The former neatly reconcile this posture with the notion of State-focused utility maximization, the latter discard it unambiguously. Both schools of thought offer accounts of regime development which are heavily tilted toward the international institutional component. The domestic scene is largely relegated to the analytical periphery. Yet, the Hong Kong open skies experience suggests that, on balance, domestic institutional factors outweigh international ones in such circumstances. The territory's low-risk strategy on this front is mostly the product of domestic influences—the China element being the sole notable exception to the rule and, even in that regard, internal and external effects may be viewed as two sides of the same domestic coin. This configuration may well be typical of bilateral legal regimes aimed at controlling private sector activity, which tend to be strongly underpinned by domestic forces at the margin, where explanatory efforts should be directed. The corollary arguably is that domestically-oriented theories of regulation should be incorporated into conceptual schemes centered on such regimes.

## VI. CONCLUSION

Hong Kong's symbolic status as the last bastion of the laissez-faire intellectual tradition may have undergone mild erosion since the heyday of the colonial era, but it remains largely intact from a comparative perspective. For the most part, the territory conducts its external economic affairs in accordance with the neoclassical logic and exponents of the Chicago school continue to extol its virtues, even if somewhat simplistically. Immigration policies are a notable exception to the rule, yet this is a

strategic domain universally governed by altogether different principles, indeed one where international law plays scarcely any meaningful role. Aviation policies also selectively qualify as an outlier, at least with respect to the open skies platform. In this sphere of externally-directed economic activity, Hong Kong has generally proceeded cautiously and, in terms of certain relevant criteria, has failed to live up to its libertarian reputation. Theories of regulatory behavior may effectively account for the gap between economically-grounded expectations and actual performance.

This specific empirical pattern is not without broader analytical implications, particularly for international legal regimes. Such systems have traditionally been explored from three conceptual perspectives, some more mainstream than others: realist, liberal, and cognitivist. Economically-inspired nationalist insights and those of the New Haven school have also provided pertinent illumination. The Hong Kong open skies experience suggests that none of these theoretical frameworks holds sway in all circumstances. Nor are they sufficient in themselves, whether individually or collectively, to furnish a wide-ranging basis for a thorough understanding of international legal regime evolution. Analytical contributions from additional sources, including domestically-oriented ones, may be needed. Last but not least, theory construction and empirical validation should not be narrowly confined to the political core of the global system but be extended to its large and significant periphery.

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