U.S.-China Aviation Relations

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RECENT DEVELOPMENTS

U.S.-China Aviation Relations†

Gabriel S. Meyer

Introduction ..................................................... 227
I. Recent Developments in the U.S. Airline Industry ........ 228
II. Recent Developments in the Chinese Airline Industry .... 230
III. On the Horizon ............................................. 231
Conclusion .......................................................... 232

Introduction

The United States and China last amended their bilateral aviation agreement in the spring of 1999. Under the agreement, four U.S. and four Chinese airlines are permitted to operate fifty-four weekly roundtrip flights between the two nations, twice the number previously authorized.¹ While the new agreement represented a substantial expansion of U.S.-China aviation ties, U.S. government and airline officials expressed frustration with the Chinese government’s reluctance to enter into an open skies agreement, which would have allowed each country’s airlines nearly unlimited access to U.S.-China routes.²

The amended accord was negotiated against a backdrop of U.S. airline industry prosperity, and Chinese airline industry uncertainty. Although Chinese government officials expressed support in principle for an open skies agreement, they contended that China’s airline industry was not yet ready to go head-to-head with the U.S. airline behemoths; the largest and, at the time, most profitable in the world.³ As U.S. carriers set their sights on domination of international markets across the globe, the fledgling Chinese airline industry continued to struggle through a gradual transition from government to free market ownership and control. Traffic levels had stagnated through much of the late 1990s and many carriers remained

† Editor’s Note: This is an addendum to Mr. Meyer's Note, U.S.-China Aviation Relations: Flight Path Toward Open Skies? 35 CORNELL INT'L. L.J. 427 (2002).
1. Protocol to the Agreement Between the Government of the United States and the Peoples Republic of China Relating to Civil Air Transport, as amended, Apr. 8, 1999, U.S.-P.R.C., Hein's No. KAV 5630 [hereinafter 1999 Amendments] (allowing the United States and China to designate up to four airlines to provide U.S.-China service, with each nation’s airlines offering up to fifty-four weekly roundtrip frequencies).
3. Id. at 442.

unprofitable, prompting the government to order an industry-wide consolidation.4

Four years later, the picture has changed dramatically. Pummeled by the combined effects of the September 11, 2001 terrorist attacks, a stagnant economy, the U.S.-led invasion of Iraq, and most recently, the global outbreak of Severe Acute Respiratory Syndrome (SARS), the U.S. airline industry has entered its darkest hour. Passenger counts have fallen more than ten percent from their pre-September 11th highs5 and a number of major carriers have been driven into bankruptcy, including United Airlines, the dominant carrier in the U.S.-China market.6 Meanwhile, the Chinese airline industry has enjoyed relative stability during the same period, benefiting from healthy increases in traffic volumes and a growing Chinese economy.7 While the U.S. government and airlines remain proponents of open skies agreements, serious discussions regarding a possible accord with China have fallen by the wayside in recent years, in light of the new world environment.

I. Recent Developments in the U.S. Airline Industry

The U.S. airline industry shows no signs of emerging from the financial crisis it plunged into in 2001. While the United States remains committed to open skies, at the moment, the U.S. government’s aviation-related priorities lie elsewhere, namely in preventing a collapse of the airline industry and protecting it from the ravages of war and terrorism.8

Since the September 11th terrorist attacks, U.S. airlines have been forced to make drastic cuts in capacity in a desperate attempt to stem surging financial losses. These losses may reach as much as $30 billion by the end of the 2003.9 Passenger counts, which fell from a high of 665 million in 2000 to 620 million in 2001,10 fell further to 601 million in 2002, a level not seen since 1997.11 This number will almost certainly drop further in 2003, due to the impact of war in Iraq.

4. Id. at 440-42.
11. Id.; AIRLINES IN CRISIS: THE PERFECT ECONOMIC STORM, supra note 5, at 22.
Passenger revenues have fallen even further, plummeting twenty-six percent between 2000 and 2002, as airlines were forced to reduce average ticket prices below 1988 levels (as measured in nominal dollars). Since the summer of 2002, US Airways, United Airlines, and most recently Hawaiian Airlines, have declared bankruptcy. Some industry observers predict that United, the world's second largest airline, will be forced to liquidate. Other smaller carriers have already ceased operations or liquidated. Furthermore, industry observers warn that barring government intervention or an unexpected change in events, most of the major U.S. carriers will ultimately be forced into bankruptcy. While the airlines initially responded to the crisis by cutting capacity and attempting to rein in labor costs, industry officials have more recently begun lobbying for a government bailout, similar to the one instituted in the days just after the September 11th attacks.

Although the U.S. airline industry is locked in a tailspin, operations on U.S.-China routes have remained largely unscathed thus far, as these routes are typically strong performers relative to others within airlines' route networks. Furthermore, cargo carriers FedEx and United Parcel Service (UPS), both of which operate U.S.-China routes, saw significant revenue and earnings growth in 2002, and appear poised to expand U.S.-China flight operations if given the opportunity.

13. AIRLINES IN CRISIS: THE PERFECT ECONOMIC STORM, supra note 5, at 10.
18. Recio, supra note 9.
However, U.S.-China markets are far from invulnerable. The recent SARS outbreak may exact a heavy and lasting toll on transpacific passenger travel.\textsuperscript{20} Its effect, combined with the war in Iraq has, at least temporarily, reduced traffic levels on transpacific routes by nearly a quarter from 2002 levels.\textsuperscript{21} A United Airlines liquidation would also have a profound effect on the U.S.-China market, as the twenty-one weekly roundtrip flights it currently operates—or nearly half of the U.S.-China frequencies allotted to U.S. carriers under the present agreement—would go up for grabs.\textsuperscript{22}

II. Recent Developments in the Chinese Airline Industry

In contrast to the U.S., the Chinese airline industry has staged a turnaround in the wake of the 1999 amendments to the agreement. Whereas four years ago, Chinese airlines were coping with the effects of over-expansion and fighting to stem financial losses, today they stand in an enviable position compared to most of the world’s airlines,\textsuperscript{23} which generated collective losses of $13 billion in 2002.\textsuperscript{24} Chinese airlines posted a collective profit of 770 million yuan in 2002, or $93 million, while passenger volume reached 84.25 million, an increase of nine percent over 2001,\textsuperscript{25} and a thirty percent increase since 1999.\textsuperscript{26} At present, China’s domestic aviation market is the fastest growing in the world.\textsuperscript{27} Predictions call for Chinese airline passenger traffic to grow at an annual rate of more than eight percent through 2021, while cargo traffic is expected to grow by nearly twelve percent annually during the same period.\textsuperscript{28}

Additionally, the Chinese government’s initiative to consolidate the nation’s airlines into three large carriers is gaining momentum. Launched in the wake of airline over-expansion in the late 1990s, Chinese officials regard this initiative as a key measure toward making their airlines competitive in the international arena.\textsuperscript{29} They expect the consolidation process to be completed by the end of 2004.\textsuperscript{30}

\textsuperscript{21.} Id.
\textsuperscript{23.} See Ben Dolven, \textit{Aviation: Dogfight Over China}, \textit{FAR EASTERN ECON. REV.}, Feb. 26, 2003 ("With the worldwide aviation market depressed, China’s is the brightest spot on [aircraft manufacturers'] horizons.")
\textsuperscript{25.} China Set to Open Skies Further to International Carriers, supra note 7.
\textsuperscript{26.} Meyer, supra note 2, at 440.
\textsuperscript{28.} Dolven, supra note 23.
\textsuperscript{30.} Id.
As the Chinese airline industry has made strides toward long-term stability, individual carriers have increasingly set their sites on international markets. Whereas in the late 1990s, many industry analysts suggested that Chinese airlines would leave most of the new frequencies granted to them under the amended aviation agreement untouched, in more recent years, Chinese carriers have gradually expanded their U.S. operations. The days when Chinese carriers had reason to fear being driven out of the U.S.-China market by unbridled competition from U.S. carriers—a factor that at one time contributed to reluctance to establish an open skies agreement—may be waning.

III. On the Horizon

Chinese aviation officials recently announced that the United States and China will begin negotiations later this year aimed at expanding air service between the two nations. According to General Administration of Civil Aviation of China (CAAC) officials, negotiations could lead to a twofold increase in the number of U.S.-China frequencies granted to each nation's airlines. Explaining the initiative, officials note that it was prompted by Chinese carriers' inability to provide new capacity on international routes. In addition to allowing more flights, an amended agreement may permit expanded code sharing opportunities for U.S. and Chinese carriers, as well as increased technical cooperation. Notably however, U.S. officials have stated that they will not push for the creation of an open skies agreement during the upcoming negotiations.

The two nations appear to have taken a realistic approach toward amending their aviation agreement. In light of the precarious state of the U.S. airline industry and the lack of capacity among Chinese airlines, few carriers are in a position to take full advantage of an open skies agreement. As a result, even if the United States and China established open skies, air service would likely increase only incrementally. An amended aviation agreement

31. Meyer, supra note 2, at 446-47.
33. Lo, supra note 27.
34. Id.
35. China Set to Open Skies Further to International Carriers, supra note 7. CAAC Minister Yang Yuanyuan stated, "We have given too much thought in the past to the relatively poor operational capabilities and acted slowly in authorizing more quotas." Id.
36. Lo, supra note 27.
37. Id.
agreement like the one under discussion, that authorizes additional flights but stops short of open skies, will probably serve the interests of both nations during the foreseeable future.

Conclusion
In the long run, an open skies agreement with China remains a possibility. In the short-run, however, prospects for such an agreement appear remote. For the U.S. government, consumed by war and the global campaign against terrorism, negotiation of open skies agreements has assumed a lower priority than only a few years earlier. Nevertheless, there is little reason for the United States to abandon its longstanding support of open skies agreements, and the benefits they bring to the nations party to them.