

## **Analysis of China's liberalisation policy with respect to international air transport**

Chrystal B. Zhang, PhD, Cranfield University, b.zhang@cranfield.ac.uk

### **1. Introduction**

Deregulation of airline industry began in 1978 when the US government took the initiative to relax the economic controls on its operation. In signing the Airline Deregulation Act into law, the US government thus demolished all the economic restrictions with one single act and created a sector that would be driven entirely by market forces overnight. In following suit, different countries adopted modified variants of this policy which was considered the best fit into their unique economic, political and physical conditions (Shaw et al, 2009).

“Open Skies” policy was initiated by the US government to support its carriers in pursuing opportunities in international market, which is governed by Chicago system. By using bagger-thy-neighbour strategy (Button, 2004), the US government was able to leverage its political and economic powers to gain all the privileges that others would never be able to enjoy and had successfully broken down the protectionistic barriers, thus substantially liberalising bilateral air transport markets with 97 countries by the end of 2009 ([www.dot.gov](http://www.dot.gov)). ICAO's statistics shows that 153 agreements involving 96 states had been concluded by 2008, providing full-market access without restrictions on designations, route rights, capacity, frequencies, code-sharing and tariffs ([www.icao.int](http://www.icao.int)).

China started its regulatory reform of the airline industry in 1980, when the Civil Aviation Administration of China (CAAC) became independent from the Air Force. As the government agency being charged with the responsibility of regulating China's air transport industry, one of the main tasks for CAAC is to develop China's international air transport policy and negotiate bilateral air services agreements with its foreign counterparts. Believing firmly that air transport is to a great extent an integral part of the national defence system, China holds that its international air transport policy is an element of the national foreign policy, which is to strengthen the country's diplomatic relations with its counterparts, and to establish new relations to suppress Taiwan. Until 2003 there had been no explicit policy regarding international air transport being spelled out in any Government white paper, such

as the Strategic Five-Year Plan. Bilateralism still dominates its international air transport negotiations, with open-skies arrangements being only moderately and limitedly accepted. As a consequence, each bilateral agreement was dealt with on a case-by-case basis, thereby giving rise to flexibility but also uncertainty (Forsyth et al., 2006). Of the 110 bilateral agreements that had been concluded by the end of 2008, only 28 contained some less restrictive provisions allowing multiple designations and unrestricted capacity ([www.caac.gov.cn](http://www.caac.gov.cn)).

This paper is intended to examine and analyse the factors that influence China's international air transport policy in an attempt of understanding this cautious, staged, and progressive course. Believing that significant developments at both international and domestic levels are fundamentally changing the conventional approach of policymaking and the weight of these driving forces is changing as the environment changes, the paper endeavours to achieve the following objectives:

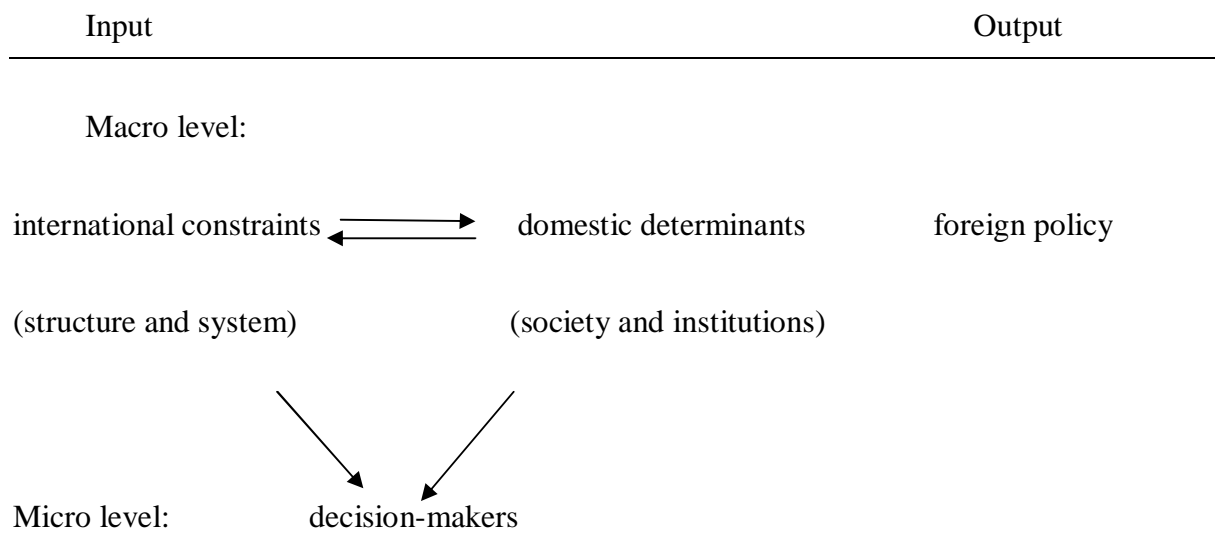
- To review China's policymaking process and identify the factors at international, domestic, and institutional levels that affect the decision-making process;
- To examine and analyse those factors to determine how they interact and influence the policymaking process
- To examine and analyse how the policy has evolved and identify how the key factors have evolved over the years;

## **2. Theoretical framework**

A Micro-Macro Linkage Approach will be employed to analyse China's international air transport policymaking process. Previously applied by Zhao in 1996 to analyse the fundamental changes in China's foreign policymaking during the 20<sup>th</sup> century, the model depicts a three-way interaction of the factors identified that have an impact on the policymaking process (Figure 1): while international constraints and domestic determinants are involved in a dynamic relationship at macro level, they also converge on, and receive feedback from, individual decision-makers (Zhao, 1996). In examining the cross-influences of the elements at various levels by focusing on the processes, situations, and structures of the

policy, the key factors could be analysed extensively including the international environment, domestic considerations, and individual behaviour which have a combined influence on the policymaking process.

Figure 1: The Micro-Macro Linkage Approach



In the case of international air transport, international conventions have no doubt restrained the policy choice for member states. The US which is the hegemonic power in the international air transport industry has definitely shaped its development and future trend. Domestically, national interests, social system, interest groups, and media are able to assert significant influence on the policymaking process. Institutionally and individually, China's bureaucratic structure, culture, and ideology have affected the mindset of the individual decision-makers who represent the country in making the policy and conducting the negotiation.

The Micro-Macro Linkage Approach will be the most appropriate for this research in that:

- It allows the examination of the factors at all levels and focuses on the interplays between them. In particular, the relativistic nature of the factors at all three levels gives the researcher the power to examine how the three levels interrelate,
- It allows the examination of the factors on a situational and case-contingent basis, which are different in terms of time, space and particular issues,

- It will be essential to interpret the causal relationships among various factors at different levels.

### **3. Methodology**

China-US and China-EU markets have been selected as two case studies for this research. One of the advantages of adopting a case study strategy is that it is an in-depth investigation of a discrete entity to look into contemporary occurrences to enable an understanding of how behaviour and/or processes are influenced by, and influence, context. It also allows the researcher to gather time series data to focus on the changing process within a specific context to enable explanations to emerge from examining patterns in the process.

China-US country-pair market is chosen because both China and the US are the two largest aviation markets in the world, with a power affecting each other and the rest of the world both politically and economically. Sino-US bilateral relationship resumed in 1978 and aviation relationship started two years later. The following years saw the airlines of both parties entering into the market and operating in the environment that is becoming less restrictive. The 2007 Protocol allowed more than 200 weekly flights phased in over a six-year period ([www.dot.gov](http://www.dot.gov)). Both governments were committed to negotiating an “Open Skies” arrangement starting from 2010 in order to develop a timescale to achieve full liberalisation. The latest round of discussion was held in Washington in June 2010.

China-EU market is chosen because EU is the first region where a full liberalisation has been achieved. China’s policy towards EU would reflect China’s view towards regional liberalisation initiatives. Though both parties confirmed their common interest in gradually opening up their aviation markets, discussions between China and the EU has not achieved much as they are conducted at individual member state level ([www.europa.eu](http://www.europa.eu)).

Data for this research has been collected through qualitative techniques including interviews, analysis of documentation and archival records, and observation. In-depth, face-to-face interviews, telephone interviews and informal conversational interviews have been conducted at various sites with various people, who have been identified as important information

source with personal involvement in the policymaking process and negotiations. Documents and records, both published and unpublished, have been reviewed. Interview records and documentary data are grouped, labelled, coded, analysed and applied to the framework identified above for this research.

#### **4. Sino-US air transport relations**

Sino-US aviation relations started in September 1980, when the ASA between the two countries was signed in Washington by the visiting Chinese Vice-Premier Mr. BO Yibo and the US President Jimmy Carter. In this agreement, two carriers from each side were allowed to operate two weekly frequencies on two routes serving four cities in the US and two cities in China. In January 1981, CAAC, the then designated carrier from the Chinese side, and Pan Am (later replaced by United Airlines) started operations on the route Beijing-Shanghai-San Francisco-New York (Route A). As a result of low demand, a second carrier from the US side did not enter the market until 1984, when Northwest Airlines started a Seattle to Shanghai service.<sup>1</sup> Three years later, CAAC began operating Beijing-Shanghai-Los Angeles (route B). However, due to low growth in demand there were only 6 flights per week between the two countries by the end of the 1980s.

Negotiations held in 1990 resulted in an agreement that one more carrier could be designated by each side and capacity was increased progressively to 27 frequencies per week in three phases. China Eastern was designated as the second Chinese carrier to operate Shanghai-Los Angeles-Seattle and Beijing-Shanghai-Seattle-Chicago in 1992, following successful negotiations with the Government to deploy its newly-acquired MD-11 aircraft on long-haul services. Evergreen International Airlines, an all-cargo US carrier was designated to commence a service between New York and Shanghai in 1993. The following winter Air China also started an all-cargo service between Beijing and New York.

Further discussions were held in 1992 and 1995 that focussed mainly on carrier performance. Unlike the previous decade, traffic grew rapidly, such that by 1998 all the 27 permitted frequencies for both parties had been used up. To meet the market demand and to help the

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<sup>1</sup> In 1983, only 130,000 passengers and 3,000 tons of cargo were carried.

carriers to develop their services, a round of discussions was held in 1999, leading to a protocol that allowed each side to designate a fourth carrier and permitted weekly frequencies to increase from 27 to 54, again in three phases. In April 2001, UPS was appointed by the US Government to start a cargo service. By the year end, the four carriers of the US side were collectively using all of their capacity entitlement, while the Chinese airlines were using only 44 of their weekly frequencies by the summer/autumn season of 2003. Though there was a demand from the US side for an immediate increase in capacity and carrier designation, the arrangement remained unchanged until 2004 when the negotiations resumed.

The 2004 Protocol was an overhaul of the original ASA with respect to market entry, code share arrangements, ground handling and offline services, with the following being agreed:

- The number of designated carriers was increased to 5;
- The capacity for operations to destinations in different zones within China was increased in phases;
- Cargo operations for carriers of both parties were opened up, with US carriers allowed to set up cargo hubs in Chinese territory;
- Domestic and third country code share arrangements were permitted between designated carriers of both parties; and
- The restrictions on commercial activities were eased in a staged manner, which included the setting up of offline offices, change of gauge and self ground handling.

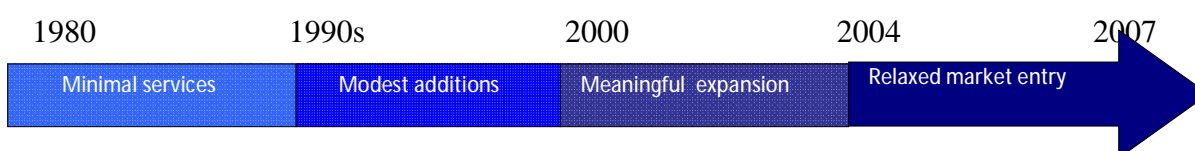
The arrangements were widely welcomed by the international aviation community, especially by the US, with the then Secretary of the Department of Transportation (DOT) stating that the protocol recognised the key role played by commercial aviation in the rapid development of Sino-US bilateral trade relations and was a landmark establishing an international air transport system that satisfied the needs of the global market. The US Department of State welcomed the protocol as a milestone arguing that the commitment of the US Government to Sino-US economic relations had brought substantial gains and would bring benefits to American industry, entrepreneurs and consumers.

By contrast to the overwhelming endorsement by the US side, the Chinese reaction was a mix of both the positive and negative, with some comparatively conservative remarks being made. The Chinese Government was pleased to see that it had been able to address the issue of satisfying the demands of the market through proactive discussions with its counterparts and that an agreement had been successfully concluded. In so doing, they were able to meet the trends of the all-embracing opening up of the country to global markets with an innovative approach, hence strengthening the economic relationship between the two countries. Korea and Singapore reacted by assessing the impact that this arrangement would bring to their carriers, while the Taiwan authorities urgently advocated a direct link across the straits so as to dilute the anticipated adverse impact on its market as a result of the more relaxed arrangement.

Chinese carriers however were more concerned about their competitiveness, taking into account their fleets and the scale of their operations, as well as their high operating costs with respect to fuel and aviation supplies. With such an open arrangement with the most competitive aviation country in the world, the Chinese Government was criticised for being unable to protect its own enterprises effectively by not giving sufficient attention to its own carriers' needs.

The consultations taking place in Seattle in July 2007 resulted in another protocol being signed, which included unlimited designation of carriers to operate services on specified routes for the Chinese side, commencing as of 1<sup>st</sup> August, 2007, and an unlimited designation of carriers for the US side, starting as of 25<sup>th</sup> March 2011. Unlimited cargo operations could commence in 2011. Both parties acknowledged that negotiations would start no later than March 25, 2010 for a full liberalisation within a time scale. The following is a summary of the liberalisation process between the two countries over the last three decades.

**Fig. 2 Gradual pace of liberalisation between China and the US**



- | 1980: Two airlines, four US cities, two Chinese cities.
- | 1990s: One additional cargo route & one new airline from each side.
- | 2004: New entrants allowed with capacity limits in place to the major Chinese cities. Free cargo operation and hub establishment in China.
- | 2007: Unlimited designation, unlimited cargo operation.

Source: Adapted from Steinberg (2007)

## **5. The driving forces of China's policy towards Sino-US market**

Despite the vibrant trade relationship between China and the US, accounting for almost half of global economic growth, the air transport market between the two countries remains restricted. There are many factors that have had an impact on China's policymaking process and the key driving forces are identified and analysed below.

### **5.1 The influence of the US**

When China and the US use the word "strategic" to denote their relationship, it can mean they are trying too hard ([www.ft.com](http://www.ft.com)). Since 1979 when the formal diplomatic ties were established, Sino-US relations have been characterised by a love-hate relationship represented by highs, such as solidarity in the war on terrorism following the attacks of September 11, 2001, and lows, a prime example being the US bombing of China's Belgrade Embassy in 1999 (Garrison, 2005). From the US perspective, regardless of which political party is in power in the White House, the China agenda usually involves a struggle between members of Congress representing competing interests and corresponding lobbying groups, and the Administration which is focused on the general health of the bilateral relationship (Garrison, 2005). From the Chinese perspective, Sino-US relations are highly emotional because the Government's policy towards America is affected by the public mood which has fluctuated so much over the past century (Hao and Su, 2005).

An engagement policy towards China was adopted in 1989 by the Administration of George H. W. Bush, who was convinced that expansion of economic ties with China would stabilise relations and lead to progress towards political reform (Garrison, 2005). He believed that the

mutual interests of the American and Chinese peoples would be best served by continued bilateral commercial relations, despite the fundamental political differences. Trade opportunities and investment should be expanded to keep China open to the outside world and responsible behaviour in areas like human rights and arms proliferation encouraged. This engagement policy has since been reinforced and promoted by later Administrations, with ever-expanding trade and economic relations becoming the centre of America's foreign policy towards China (Garrison, 2005).

A mechanism was set up in 1983 to address the inevitable challenges and differences of the complex bilateral trade relationship. The Joint Commission on Commerce and Trade (JCCT), a high-level government-to-government dialogue, has been very successful in seeking to open market and resolve trade disputes. Accomplishments have included the commitment by China to sign the World Intellectual Property Organisation Internet Treaty in June 2007 and the Tourism Memorandum of Understanding in December 2007 to facilitate China's outbound tourist groups to the US ([www.doc.gov](http://www.doc.gov)).

Strategic Economic Dialogue (SED), another cabinet-level forum, set up in September 2006, was designed to provide an overarching discussion of on-going bilateral economic issues, cross-cutting issues and long-term strategic challenges ([www.state.gov](http://www.state.gov)). The SED worked effectively to manage the immediate tensions and long-term issues producing tangible results in economic and non-economic areas (Paulson, 2008). A showcase of the accomplishments of the SED was the successful conclusion of the 2007 Protocol with respect to air transport arrangements.

In April 2006, meetings to discuss how to develop air transport services commenced. While the US side wanted to have a full open skies arrangement involving unlimited designation of carriers and unlimited cargo operations, China was convinced that it did not want such a deal at this stage due to its insufficient infrastructure and the unused traffic rights available for Chinese carriers from the 2004 Protocol. The discussions did not progress due to the differences between the two parties. However, things started to get moving again when the issues were brought to the attention of Madam WU Yi and Henry Paulson who co-chaired the third round of the SED, with the above mentioned Protocol being concluded in April 2007.

This eliminated all restrictions on the number of cargo airlines and flights, thereby allowing all-cargo airlines to optimise their global route networks. Agreement was also reached on doubling the permissible market capacity and removing restrictions on Chinese carriers that could enter the market. What is more significant is that both parties agreed that discussions about full Open Skies arrangements should start no later than March 2010. Paulson recalled in 2008 that “lower-level negotiations on such (bilateral air services) an agreement had been stalled for some time because China was focused on developing the competitiveness of its domestic aviation industry and limiting international competition. But through the SED, I brought this issue to the attention of my counterpart, then Vice Premier Wu Yi, and explained how the increased exchanges of people and goods between our two countries would strengthen the relationship. Thanks to the agreement, US passenger flights to and from China will more than double by 2012, and air-cargo companies from both countries will enjoy full liberalisation of the industry, including the lifting of restrictions on the frequency and price of flights, by 2011”.

Seeing the benefits of addressing the economic differences at a political level, the Obama Administration has been determined to continue with this policy mechanism. By inaugurating a fresh “Strategic and Economic Dialogue” in July 2009, the two parties aim at building a positive, cooperative and comprehensive relationship for the 21<sup>st</sup> century ([www.state.gov](http://www.state.gov)). The dialogue will enable both parties to address such things as “climate change and energy, which is an economic issue, a diplomatic issue, a development issue, an energy issue, an environmental issue, an agricultural issue and a national security issue...in its full complexity” (Clinton, 2009). Aviation, as one of the economic areas within this broad framework, will undoubtedly be on the agenda for future discussions.

## **5.2 The influence of US Open Skies agreements with neighbouring countries**

The US started to export its Open-Skies initiatives to Asia in 1996, with Macau being the first to conclude such an agreement in March the same year. Ever since then, the US has successfully concluded Open Skies with Singapore (Jan. 1997), Taiwan (Feb. 1997), Malaysia (Jun. 1996), Uzbekistan (Feb. 1998), South Korea (Jun. 1998), Pakistan (Apr. 1999), Hong Kong (Oct. 2002), Indonesia (Jul. 2004), India (Jan. 2005), Thailand (Sept. 2005), Laos

(Oct. 2008), and Japan (Dec. 2009), leaving China to be one of the few countries in the region that are still in the process towards full liberalisation. Carriers such as those in South Korea and Japan have taken the advantage of the freedom of traffic rights by flying more traffic between China and the US via Seoul and Tokyo, as John Jackson, Korean Air's North America Marketing Director noted that the "US carriers cannot expand their frequencies like this (near doubling of Korean Air flights) due to limited traffic rights. We have Open Skies with China and an enormous North American network. This gives us an edge and supports our goal of becoming the preferred airline to China" (Steinberg, 2007). Statistics showed that around 16 percent of US-China passenger traffic in 2006 was being lost to third country carriers (Steinberg, 2007).

CAAC was fully aware of the achievements made by its neighbouring counterparts. At each round of negotiations, these governments and their carriers would request to have full access to Chinese market, leaving the Chinese side to react accordingly. Appreciating that relaxing the economic restrictions is inevitable, the key issue remains how soon and how quickly this can be achieved. In 1990s when the concept of Open Skies was just started to be picked up in Asia, China did not see the necessity for a liberalised environment for its businesses being convinced that intervention was imperative to guide the country through adverse economic cycles, such as the financial turmoil experienced in Southeast Asia in 1997. While in the 21<sup>st</sup> century, Open Skies becomes a subject in almost every bilateral negotiation, the consideration was not whether to acknowledge it or not, but to what extent it should be accepted. "We should open our market selectively and gradually in order to promote market prosperity and improve the service level and competitiveness of our businesses through the introduction of competition in an open environment" as acknowledged by CAAC.

### **5.3 Impact of WTO and ASEAN**

The accession to the WTO was a big push for China to speed up its liberalisation process. Williams (2009) observed that Chinese Government has been progressively seeking to satisfy the externally imposed and measurable forms of compliance with the legal requirements, regulations and rules that are a condition of full membership of the WTO since 1990s. For aviation sector, the efforts started in 1999 when China signed a new aviation agreement with

the US, which significantly expanded commercial services between the two countries. Zhang and Chen (2003) further pointed out that joining the WTO caused China to adopt more liberal attitudes towards international air transport. Zhang (2001) noted that the entry has brought about a series of policy changes in the following years. For example, more liberal ASAs between China and the US, between the Mainland China and the Hong Kong SAR, and between Hong Kong SAR and the USA have been concluded giving airlines more authority for operation at their will. He argued that WTO provided a good opportunity for Chinese carriers to expose to competition with more efficient airlines, and offer some obvious advantages for the integrated express air cargo sector. WTO would also be a good time for China to consider a SAR Hong Kong-Mainland open skies bloc to allow the country to gain valuable bilateral and multilateral experience, and possibly consider an Open Skies Bloc for Northeast Asia with Japan and South Korea, where economic growth has continued over the last two to three decades and the intra-country trade and economic link has been strengthened and expanded over the years.

The involvement with ASEAN in November 2001 was another push for China to liberalise its air transport market, when a joint agreement was signed to establish an ASEAN-China Free Trade Agreement by 2011, which included a decision to advance discussions towards an ASA between China and ASEAN. The Memorandum of Understanding (MOU) signed in 2004 between China and ASEAN on Transport Cooperation set the roadmap for both parties to integrate air travel so as to fit into the long-term plan of the ASEAN countries to fully liberalise their air services and create a single aviation market by 2015 (Williams, 2009). Though there is scepticism about the possibility of achieving full liberalisation by 2015, at least it demonstrated the commitment of the governments to work towards this common goal.

CAAC's approval of the agreement reached between Hong Kong and the US was a prelude of the central Government's commitment to progress the liberalisation process. According to the Hong Kong Basic Law, over the next 50 years following the hand-over in 1997, Hong Kong's regulatory system would remain unchanged, and the Hong Kong authority was authorised to negotiate its own bilateral agreements with any third country, though this would have to be agreed to by the central Government. This applies to air transport arrangements. The 2002 Agreement following three years of discussions allowed US carriers to have fifth

traffic rights at Hong Kong, enabling them to operate 58 frequencies per week to Japan, South Korea and other Southeast Asian countries and regions, including the Philippines, Thailand and Taiwan and to carry freight to the rest of the world, excluding Australia and Japan though the request of Cathay Pacific to fly to South America and Europe via the US was denied ([www.asiatimes.com](http://www.asiatimes.com)).

## **5.4 Domestic forces**

In analysing China's foreign policymaking, Hao and Su (2002) argued that domestic forces are becoming extremely important in understanding the processes. These forces had been accommodative for decades but are now pulling in different directions. Chinese policymakers are increasingly constrained by societal pressure, despite the fact that they might have a much wider degree of latitude for action than their western counterparts. In the case of liberalising the international air transport market, domestic situation was usually given priority in formulating liberalised policy and to determine to that extent the restrictions should be relaxed (Zhang and Chen, 2003). Zhang (1998) noted that China's regulatory reform in the air transport sector in the 1980s and argued that the industry was reacting to the central government's call to transform thousands of large- and medium-sized state owned enterprises (SOE) to profit-seeking economic units in the market economy. Williams (2009) argued that the underlying political aspect of China's civil aviation industry played a bigger role than that in any other country of the world, with the policy being to respond to the national policy objectives such as advancing economic development on a massive scale in those provinces that have yet to fully share in the economic and social rewards of market liberalisation and reform, and to contribute towards the development of the central and western provinces. To include most airports in central, western and northeast region of the country in the 2004 and 2007 Protocols with the US was CAAC's reaction to support the call of the central government to further develop these regions in their economic growth.

## **5.5 Influence of stakeholders**

### **5.5.1 influence of Chinese stakeholders**

Stakeholders generally are involved both directly and indirectly in the process of policy-making. This also holds true in China, though the approach of influence is different from that in the West due to the different political system and cultural background (Gao and Tian, 2006). Interest groups cooperate in lobbying for common interests but compete for individual benefits.

The airline industry in China was profitable between 1978 and the late 1990s. The financial crisis in Asia brought a loss for the first time in 1998, with a combined loss of 560 million Yuan being recorded in 2000 ([www.caac.gov.cn](http://www.caac.gov.cn)). The terrorist attacks in 2001, SARS and the high fuel price in 2003 made things worse for Chinese carriers, with the big three recording a loss of 42.74 million Yuan ([www.caac.gov.cn](http://www.caac.gov.cn)). Beijing Capital Airport handled only 24.4 million passengers in 2003, representing a 10.3 percent decrease over 2002 ([www.bcia.com.cn](http://www.bcia.com.cn)). The following years saw an improvement in the profitability of the industry, but the global financial crunch that started in 2008 plunged the airlines into crisis again with the big three airlines reporting a total loss of US\$2,254 million ([www.carnoc.com](http://www.carnoc.com)).

In the Sino-US market, Chinese carriers in general have not performed as well as the US carriers. This was reflected first of all by the unutilised traffic rights available for the designated Chinese carriers. The 2004 Protocol allowed each party's 7 designated carriers to operate up to 133 frequencies per week. By April 2006, the seven US carriers were operating 132 flights per week (63 passenger services and 69 cargo services), while the seven Chinese carriers only operated 65 frequencies (37 passenger services and 28 cargo services).

The unsatisfactory performance of Chinese carriers was also reflected by the decrease of traffic and market shares, as demonstrated by Figures 3 and 4. The market shares of the Chinese carriers have halved from almost 80 percent in 1996 to around 40 percent in 2007. In 2004, total passengers carried between the two countries were 1.46 million and of these, Chinese airlines only carried 581,000. In 2007, a total of 2.62 million passengers were carried, but Chinese carriers only accounted for 864,000, representing a 7 percent decrease in market share over 2004 ([www.caac.gov.cn](http://www.caac.gov.cn); [www.dot.gov](http://www.dot.gov)).

Fig. 3 Passenger traffic carried by airlines between 2000 and 2006

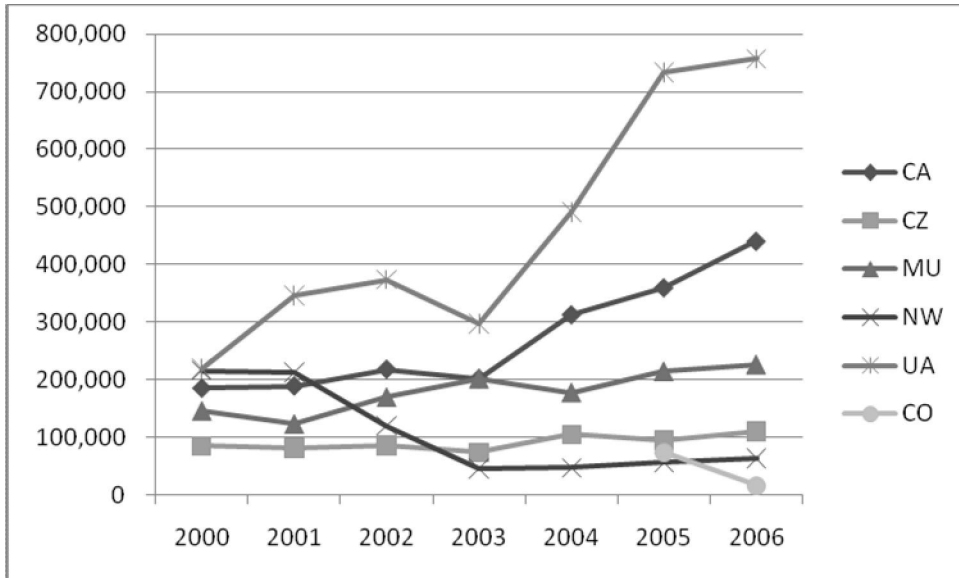
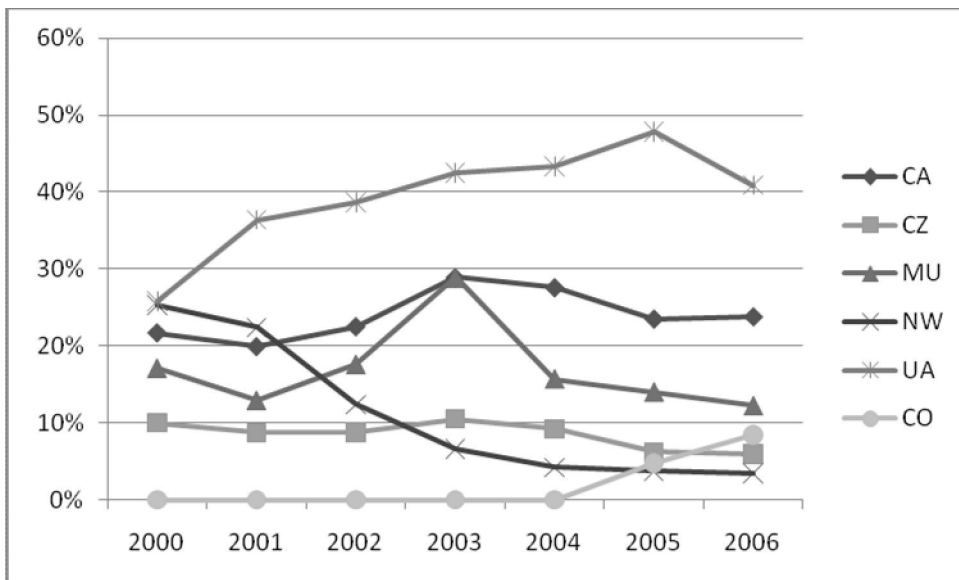


Fig. 4 Market shares of airlines between 2000 and 2006



Source: [www.caac.gov.cn](http://www.caac.gov.cn); [www.dot.gov](http://www.dot.gov)

The sharp fall in market shares as well as the poor financial performance caused the dissatisfaction of Chinese carriers with the relaxed arrangements. Air China, China Eastern, China Southern and China Cargo, were very reluctant to increase their operations, being fully aware of their current financial situations and the fierce competition from their aggressive international rivals. None of them was in favour of any kind of relaxation in the restrictions, in particular, increased designations and frequencies, free commercial arrangements and

establishment of cargo hubs. They argued that there were still traffic rights available between the two countries which needed to be exploited, and that the US's strict visa procedures for Chinese citizens prevented them from generating more market demand. After the 2004 Protocol, they complained that the Government was not protecting them effectively by having given too many opportunities to their competitors.

Compared with the incumbents, cargo carriers were extremely interested in expanding into international market. Great Wall Airline, Jade Cargo International, Shanghai Cargo Airlines and Hainan Airlines all applied to CAAC in 2003 and 2004 for Sino-US route licences, with the reasons given being to respond to the Government's call to promote cargo traffic and enhance international trade by taking advantage of their respective bases in Shanghai and Shenzhen, where the majority of China's export products are manufactured.

Contrary to the airline industry, airports in China have demonstrated great support to liberalisation. Over the years, passenger throughput at Chinese airports has increased at an average rate of 16.8 percent with 387.6 million being handled in 2007, though 91 percent being domestic traffic ([www.caac.gov.cn](http://www.caac.gov.cn)). Beijing Capital International Airport received 48.7 million passengers in 2007 compared with 21.7 million in 2000 ([www.bcia.com](http://www.bcia.com)), while passenger traffic at the two Shanghai airports increased from 17.7 million in 2000 to 51.55 million in 2007 ([www.shairport.com](http://www.shairport.com)). Operational efficiency and productivity of larger airports such as Beijing, Shanghai and Shenzhen has been improved too. The airport localisation programme which started in early 2000 and was completed in 2004 transferred the ownership and control of all airports (except Beijing and Tibet) to the local respective government ([www.caac.gov.cn](http://www.caac.gov.cn)), hence enhancing their enthusiasm to develop the air transport services. They wrote to CAAC asking for the removal of the restrictions on capacity so as to allow them to rationalise their route network to attract more international traffic. By allowing more international carriers into the airports they were able to strengthen their hub status to compete with Icheon and Hong Kong. Guangzhou, one of the strategic objectives being to open more international routes, would welcome more US carriers so that it could develop itself into a regional hub to cover Southern China and Southeast Asia.

Airports are joined by local governments which voiced strong preference for an open market. With their access to senior level officials in bureaucracies, these local governments are more powerful in exerting influence on policymakers. Since 2003, tens of MOUs have been signed between CAAC and the local governments including Hainan, Jiangsu, Zhejiang, Fujian, Heilongjiang, Jiangxi and Henan provinces ([www.caac.gov.cn](http://www.caac.gov.cn)), in which CAAC pledged to provide full support in their pursuit for international services by both Chinese and international carriers.

Hainan Province was a best showcase of the successful lobbying by the local government. Separating from Guangdong Province in 1988, Hainan was given special policies to stimulate its economic growth. Without much manufacturing or agriculture, tourism industry is the key for Hainan's development and establishing international links became the priority for the local government.

The idea of opening more international routes was initiated by Hainan Airlines in late 2002 and early 2003, which after ten years of operation, saw the need to expand into a bigger domestic and international market. The initiative gained immediate support from the then Party Secretary of the province Mr. WANG Qishan, currently a Vice Premier. "A proposal to have Hainan Province open for third, fourth and fifth traffic rights on a pilot basis" was submitted to CAAC in February 2003 and was approved the following month. A special "flight management office" was set up and very generous incentives were in place to attract international traffic.

Contrasting opinions of industry stakeholders left CAAC in a situation where they had to seek an acceptable balance. "At the international level, national governments seek to maximise their own ability to satisfy domestic pressure, while minimising the adverse consequences of foreign development. At the national level, domestic groups pursue their interests by pressuring the Government to adopt favourable policies, and politicians seek power by constructing coalitions among those groups" (Putman 1988).

With all voices being heard and interests considered, the outcomes of the 2004 negotiations were a mixed blessing. Shanghai Cargo and Hainan Airlines were overjoyed with what they

had achieved, being designated as carriers in the Sino-US market. Guangzhou airport was chosen by FedEx to be its Asia Pacific hub to replace Subic Bay, with the contract being signed in July 2005 and operations starting in February 2009 ([www.baiyunairport.com](http://www.baiyunairport.com)). For Hainan Province and other Mid-western and North-eastern provinces, their opening for operations with free traffic rights was officially documented in the Protocol. On the other hand, Air China, China Eastern and China Southern were very upset, commenting that their interests were not being properly protected ([www.carnoc.com](http://www.carnoc.com)).

### **5.5.2. Influence of the US stakeholders**

The US, which has a history of corporate-led trade policy, is very keen to support businesses in their initiatives for international expansion. Deeply imbedded in their institutions, the Government is supported by business and their interests are reflected in national policies. The international trade negotiations provided the best platform for the Government to realise their commitment to business development, as was made clear by Franklin L. Lavin, the Undersecretary of Commerce for International Trade, at the China Roadshow Conference in May 2006: “US trade policy in relation to China is all about helping US companies compete in China, and how we are working to improve the conditions that allow US companies to compete in China”, and “the Commerce Department wants to do everything possible to help US companies compete in China and we do just that everyday”.

The Guam Islands provide an example of how successful lobbying can be in supporting strategic initiatives. Being the largest island in the Marianas archipelago in the middle of the Pacific Ocean and close to Asian countries, Guam is an unincorporated territory of the US. With a US military base, it does not have many industries. Witnessing Saipan’s robust growth through attracting large numbers of Chinese visitors, the Guam Authority started a lobbying campaign in 2006. They commissioned specialised consultancy firms to support them in lobbying both the Chinese and US Governments; they sent senior delegations to visit China resulting in a Memorandum of Understanding promoting Chinese visits to Guam; and they proposed to designate a GSA in China to coordinate with airlines and travel agencies to organise group tours to Guam. Eventually, Guam was included in the 2007 Sino-US Protocol

in which both parties agreed to have Guam as a stop-over for carriers of both parties without any limitations on traffic rights and with visas arranged for Chinese visitors ([www.guam.gov](http://www.guam.gov)).

## 6. Conclusion

The year 2008 marked the 30<sup>th</sup> anniversary of China's economic reform. Over the years, China's air transport industry has undergone a long, gradual and progressive reform process. With the momentum for liberalisation being gained in 2002 when China became a member of the WTO. Reacting to the dynamic international environment, domestic considerations and institutional changes, CAAC needs to do its utmost to satisfy the requirements of Chinese businesses who are only interested in selective markets, where they believe that they can operate profitably given their capabilities and competitiveness, while at the same time, it has to take into account the demand from foreign governments and their carriers which request full access to Chinese market. Being integrated into the Ministry of Transport as a result of structural reform launched by the central Government in March 2008, thus creating more bureaucracy in the decision-making process, and China's strategic focus being diverted to optimising the opportunities available from unused traffic rights and to developing competitive international airlines and hubs in order to have coordinated and sustainable development of the industry, CAAC needs to consider how to balance the various interests of various parties. "China's reform and its success relies on the appreciation of the circumstances of Chinese characteristics rather than the blind copy of foreign experiment. The key is to manage the relationship between the extent of reform, the pace of growth and the acceptable level of society. The fundamental principle to guide the future development of China's air transport industry will be to advance the reform while seeking societal stability and to reinforce this stability through reform" (Li, 2009).

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