THE DRAGON AND THE EAGLE — A STUDY OF U.S.-CHINA RELATIONS IN CIVIL AIR TRANSPORT

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THE DRAGON AND THE EAGLE — A STUDY OF U.S.-CHINA RELATIONS IN CIVIL AIR TRANSPORT

China’s civil aviation will expand and modernize in the next five years to keep pace with the growth in socialist construction, foreign relations and tourism. A just-ended civil aviation meeting decided to add more Chinese international and domestic air routes, speed the construction of big, modern airfields and train more air crews to improve the service . . .

Hsinhua News Agency, Peking
February 23, 1978

INTRODUCTION

Inasmuch as business flying is now an economic fact of life in the modern world, it was relatively unknown sixty-five years ago. In China, because of persistent conflicts at home and abroad and the predominance of the traditional economy and means of transportation, commercial aviation has a history of less than half a century.

China first witnessed the “flying machine” in 1909 and like the rest of the world, it was immediately impressed by its vast economic, political and in particular, military potentials. However, in spite of early Chinese interest in aviation, it was not until twelve years later that the myth of flying became a reality for the public. By 1932, the Nationalists had finally laid down the foundations of an air transport system comprising some 14,000 kilometers of air routes, with a Sino-U.S. and a Sino-German airline operating a total of thirty planes of varying sizes and models. Prior to the Communist takeover, China had three airlines equipped with some one hundred aircraft in active service. By then, commercial air services had connected the central with the southwest, southeast and northeast and had managed, on the international front, to reach Southeast Asia, India, Japan and the United States on a limited basis. On the other hand, in aircraft manufacturing, progress and production were very restricted. As is the case with commercial airlines, foreign investments were dominant in this area.

The founding of the People’s Republic of China (PRC) in 1949 ushered in new changes and experiences for the industry as a whole. Under Communism, civil aviation in China went through
some very strenuous times. Much of this was due to the civil war which virtually depleted the country's civil air fleet, airfields and navigational equipment as well as trained personnel. Therefore, the new government faced a seemingly insurmountable task in rehabilitating the air transport sector. With less than twenty-eight aircraft operational and none of the previously organized airlines left at its disposal, the PRC set off to establish civil aviation step by step.

Initially, two airlines, one of which was a joint venture with the Soviet Union, were formed. Attention was directed towards airfield reconstruction, aircraft repair and maintenance in key areas. Measures were also taken in the direction of administrative organization. With continuing efforts, a discernible system of domestic air services began to take shape. In less than eight years, route mileage and overall freight and passenger turnover more than doubled. Moreover, in contrast to the previous decades, the industry formed an integral part of national economic planning and became actively involved with geological surveys, aerial photography and agricultural and forestry production. By 1955, all air services at the mainland had been consolidated into a single national airline — CAAC, the General Administration of Civil Aviation of China. For the first time, air transportation in China became totally state-owned and operated. While this was a feat in itself, there was unfortunately no similar growth in aircraft manufacturing. By the same token, although it is evident that progress in civil aviation in the People's Republic has been sure and steady through the years, the same, however, was not true of the economic and socio-political order. In that respect, there were many ups and downs. The Great Leap, the ensuing economic retrenchment and recovery, and the Cultural Revolution were but examples of such vicissitudes. Nevertheless, development in civil aviation is presently more encouraging.

After the Cultural Revolution had climaxed and subsided, and the Gang of Four came and went, the PRC seems to be now experiencing truly stabilizing changes at home and abroad. Today, while an invigorative and ambitious economic and developmental plan is being actively pursued within the country, pragmatism is dominating Peking's policy towards the world at large. To the extent these developments have resulted in a substantial increase in the PRC's political, economic and cultural contacts with the West, they have stimulated concomitant and unprecedented growth in both its domestic and international civil air transport.
Indeed, notwithstanding natural calamities and political upheavals within the country in the past few years, Peking’s official press Hsinhua reported at the end of 1977 that the Chinese People’s Republic now has over 100 domestic air routes linking more than eighty cities. This represents at least a six-fold increase from three decades before. Starting with only four international routes ten years ago, the Chinese airline CAAC has also emerged from isolation and added another six making a record total of ten in 1978. Meanwhile, as Canada and the United Kingdom are still battling for landing rights, flag carriers from nine other nations offer air services to the Chinese mainland on a regular basis. At present, besides being signatories to the Chicago and Warsaw Conventions, Peking is party to over thirty bilateral commercial aviation agreements. Already a member of the International Civil Aviation Organization (ICAO), China now contemplates active participation in the International Air Transport Association (IATA).

In terms of achievements in civil aviation, the People’s Republic has far surpassed its predecessor. Nevertheless, by international standards, CAAC’s domestic and international performances still put the PRC behind such Third World countries as Argentina, the Netherlands, Malaysia, India and Pakistan, among others. In view of Peking’s present commitment to nation-building, the prospects and problems of sustained progress and participation in domestic and international aviation (especially in a manner that corresponds to the needs of its economic and political developments) will become a matter of serious concern to the Chinese in the times ahead. Admittedly, air transport to the PRC will remain secondary to traditional modes of transportation such as railroad, motor and even water transport in the foreseeable future, but that would not necessarily undermine its immense potential value to the new national development objectives.

To begin with, on the domestic level, as industrial growth leads to decentralization, a viable air communication system still offers the best means of integration in the economic and political sense. If allowed to grow, the system can provide new employment and industry opportunities. With reference to the latter, assuming that China continues to import foreign technology and equipment to expedite its industrialization, it will inevitably begin to appreciate air freight as a tool for development. By utilizing air freight, foreign shippers are able to dispatch ultra-high value cargo promptly, and to speed delivery and effect the timely
replacement of broken or worn parts. In turn, the Chinese can minimize costs in inventory control. Similarly, air transport can improve export earnings since it enables PRC exporters to better respond to unpredicted product demand, attain greater flexibility of delivery schedules, and deliver perishables (such as fresh crabs and fruits) in prime condition.

As a means of offsetting capital outlay for foreign imports, the PRC government has recently announced its decision to promote its tourism industry. Without aviation, this cannot be properly done. Realistically, in order to tap tourist sources, China must not only improve its present travel services, but it must develop new and far-reaching routes overseas. If successfully done, this would have the additional effect of promoting Peking's political relations with friends and foes among nations abroad. Moreover, in developing and operating far-flung international routes, CAAC pilots and navigators can acquire practical experience which could prove valuable in times of war. Although not immediately apparent to most people, this aspect is especially of interest to the Chinese in their present state of concern for military preparedness against the Soviet Union.

In terms of route-planning, blessed with a travel-conscious population and as a springboard to Latin America and beyond to Western Europe, the United States is inevitably a focal point in CAAC's overseas development plans. But apart from that, a U.S.-PRC air link would be desirable in the context of rapprochement. Equally important, it would facilitate direct and frequent travel of Chinese officials to the United Nations, and thus would render more active and meaningful the PRC's participation there. Furthermore, if a bilateral air agreement is successfully reached, Peking would regard it as acceptance by the acknowledged leader of the aviation community. With this in mind, therefore, Part One of this study examines the problems and possibilities involved in the development of this aspect of civil aviation relations between the two countries.

In the final analysis, however, ambitious though it may be, China's domestic and international aviation expansion scheme cannot be fully implemented without an adequate and up-to-date civil air fleet (complete with parts supply) and a competent corp of management, flight, maintenance and operations personnel. Although the PRC has acquired some forty-five jetliners in the last seven years (including, of course, the ten Boeing 707s from the United States), it will require more planes and trained people for aviation development commensurate with its economic and
political advances at home and abroad. Unlike route development, the build-up process in this instance is both costly and time-consuming. The problem is that China is not presently self-sufficient for this purpose. Hence it would necessitate import of foreign aircraft and technology which is ideologically contradictory to Peking's traditional belief in self-reliance or "walking on two legs." This poses an interesting but fundamental question for the present study which Part Two will further explore.

Assuming that China does turn to the West to acquire such aviation technology and equipment, the U.S. will no doubt be one procurement possibility among many. Insofar as American aircraft manufacturers are concerned, the question is as much one of "will China do it?," as "how will China do it?." And what are the opportunities and prospects? Toward that end, Part Two of this study offers an assessment and some speculations.
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PART ONE
U.S.-CHINA AIR TRANSPORT SERVICES — A CASE OF CONTROL, CONFLICT AND COMPROMISE

... (state) Department and CAB anxious conclude bilateral air transport agreement with China soonest possible ...

Telegram, Acting Secretary of State Dean Acheson to the Ambassador in China, Stuart Leighton, August 9, 1946

I. The Background
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The saga of Sino-U.S. air services began informally over thirty-seven years ago when the "China Clipper" of Pan American extended its pioneer mail route across the Pacific to Hong Kong in an effort to connect with the network of the now-defunct China National Aviation Corporation (CNAC) on the Chinese Mainland.¹ It was not until nine years later, in 1946, that the Nationalist government officially came to terms with the United States on an agreement which provided for flights between the two countries.² In the following year, CNAC — as flag carrier designated by China — began to operate twice weekly from Shanghai to San Francisco via Honolulu. At the other end, Northwest Airlines and Pan American applied for and obtained permission to serve the Mainland. Operations to Shanghai commenced in the same year.³

The Communist takeover of China in 1949 brought an untimely end to the growing traffic between the Chinese Mainland and the United States. However, the 1946 Sino-U.S. Air Agreement was never formally repudiated by the United States or the PRC. Instead, with an Exchange of Notes in 1969, the Republic of China (ROC) and the United States amended the

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¹. CNAC was a Sino-U.S. joint venture airline formed in China in 1930. In March 1933, Pan Am acquired the entire American share in the company.


³. For detailed account of the China route award to the U.S. carriers, see Pacific Case, 7 C.A.B. 209 (1946).
Agreement to enable a new air service to function between Taipei, Taiwan and the west coast of the U.S. Under a Foreign Air Carrier Permit issued by the U.S. Civil Aeronautics Board (CAB), China Airlines — flag carrier of the ROC — began its first operations from Taiwan to the United States in 1969, and currently it serves the three U.S. cities of Honolulu, San Francisco and Los Angeles. On the American side, Northwest, TWA and Flying Tiger were initially given authority under the new amendment to operate into Taiwan on a regular basis.

The twenty-two year air incommunicado with Mainland China finally came to an end when two aircraft belonging to TWA and Saturn Airlines, respectively, made their historical landings in Peking in 1971 to pave the way for President Nixon’s first visit to the PRC. Thereafter, events took a sudden turn for the better. Following a series of measures by the Administration which removed virtually all restrictions — collectively known as “Transportation Order Two” — on U.S. citizen and aircraft travels to the Chinese Mainland, the American people and airlines are now theoretically able to visit the China Mainland again. The sale of ten Boeing 707s in 1972 helped break the barrier even further. With the progressive normalization of U.S.-PRC diplomatic, trade and cultural relations, the stage seemed set for the resumption of bilateral air services.

In this spirit the delegation from the U.S. National Council for U.S.-China Trade to the PRC in 1973 conveyed to the Chinese its hope and willingness to encourage the “development, step by step, of reciprocal . . . air services . . .” which it considers as fundamental to the “. . . progressive development of trade and economic relations . . .” between the two countries. Meanwhile, in the hope of strengthening both their prestige and present route structure, Pan American, TWA, United and Capital International hurriedly filed applications with the CAB for the appropriate

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operating authority to China. However, in spite of zealous response from U.S. carriers and some members of the Congress, and the informal visit of the president of Pan American Airways to China in 1974, plans for the inauguration of regular two-way air traffic with the People's Republic have not materialized. Since no direct regular air service currently exists between the American continent and Chinese Mainland, U.S. and Canadian visitors to China, as well as importers and exporters involved in the China market, are constrained to use foreign airlines originating in Japan, Pakistan, Europe and Africa.

THE VIEW FROM ROC

By contrast, however, American travellers have been calling on Taiwan with a minimum of inconvenience. At present at least three airlines, including an American carrier, are operating regularly between the U.S. and Taiwan; and traffic load factors have been impressive. For China Airlines alone, the number of passengers flown on the U.S.-ROC route doubled and cargo tonnage increased 160% over a period of five years. In 1977 this route not only contributed substantially to the airline's $20 million net earnings, it helped finance the purchase of four Boeing 747s.

Understandably, the Nationalist Chinese are elated that American fantasy for direct air link with the People's Republic has thus far ended in frustration. To them reopening of the U.S.-PRC route might mean the end of the air transport agreement and services between the U.S. and the island Republic. The repercussions, in that case, would go beyond simple financial loss. Among a total of twelve air transport agreements which presently exist between the ROC and foreign countries, the Sino-American Agreement is the only one which was concluded on a permanent and formal basis. To the Nationalists, therefore, it has symbolic

8. The four cases now pending decision are: Pan American, No. 24390-1; TWA, No. 24816, 24074; United Airlines, No. 21779; Capital International Airways, No. 25978. All references to dockets are those as filed at the Civil Aeronautics Board, Washington, D.C.

9. At present Japan Airlines, Pakistan International Airlines, Air France, Swissair, Iran Air, Tarom and Ethiopian Airlines (and Aeroflot, Civil Aviation Administration of DPRK as well) operate to China.

10. See For Airline Read Diplomat, FAR EASTERN ECON. REV. (Hong Kong) January 20, 1978, at 57.

11. The Republic of China now has standing provisional civil air agreement with South Korea, Singapore and Indonesia. Air transport agreements have also been reached with civil aeronautical authorities of Nauru and Saudi Arabia. The
significance as a demonstration of continual acceptance by the international aviation community. More significantly, it is also the hallmark of long-standing political, economic and cultural relationships between Taiwan and the United States. Indeed, at a time when ROC’s self-perceived destiny is increasingly threatened by worldwide political isolation and normalization of American relations with Peking, any change in the Sino-U.S. Air Agreement of 1946 prior to official “de-recognition” can adversely affect confidence in the Island at home and abroad; this the ROC Government cannot afford. Thus, the continuing existence of the Agreement in its present form becomes an imperative — a sign of United States reassurance — the absence of which forebodes the beginning of an end to U.S. support and Nationalist rule in Taiwan.

THE BEST OF TWO WORLDS?

In the long run, however, all parties concerned — the U.S., PRC and even ROC — would agree that resumption of air services between the American and Chinese mainland is inevitable. The question is only one of “when” and “how.” Much, of course, depends on U.S. strategy toward normalization of relations with Peking. But, whether resumption is now or after diplomatic recognition of the PRC, the Carter administration would want to preserve various ties with Taiwan, if only to protect U.S. investments which amount to over $550 million. Moreover, the American public is supportive of continuing relations with the ROC. In that context, sustainment of the existing air link with Taiwan is clearly necessary and conducive to the U.S. interest. 13

What, then, are the realistic prospects of opening up the PRC air route while maintaining the status quo in U.S.-ROC aviation relations? The pages that follow examine that question as well as the intricacies and problems inherent in this facet of a truly

remaining six air agreements were signed by China Airlines on a private contractual level. The other six airlines are Philippines Airlines, Malaysian Airlines System, Thai Airways International, Ltd, Cathay Pacific Airways, Japan Asia Airways and Luxembourg Airways. See China Airlines, Head Office, Taipei, Taiwan, A Summary of Contents of Our Nation’s Present Air Transport Agreements (unpublished document originally dated November 27, 1972); see also subsequent update in Central Daily News (Taipei), March 29, 1977.

12. Taiwan is not a member of ICAO; and China Airlines is not an IATA member.

unique triangular relationship. The focus is on the domestic and international legal complexities involved, the decisive role of the U.S. president and the reach of law and politics in ultimate decision-making under the circumstances. For the purposes of the present analysis, the author has made two assumptions. First, the ongoing normalization process will culminate in U.S. recognition of the PRC as the sole legitimate government of China in the very near future. Second, the issues of blocked assets and U.S. private claims will be amicably and satisfactorily resolved between the two nations in the process so that the single major barrier to resumption of bilateral air services will be effectively removed.

II. American Law, Foreign Policy and International Aviation

A Question of Before and After

As with other areas where the U.S. is seeking reapprochment with the PRC, the problem of maintaining simultaneous air ties with Peking and Taiwan may be best examined by juxtaposing American objectives and obstacles which develop before recognition with those which emerge subsequent to it. Before recognition, the proposition is essentially one of opening up the Mainland China air route in the absence of formal diplomatic relations with Peking, and in the face of existing U.S. treaty commitments to Taiwan. The problem takes on a different dimension after the U.S. has officially recognized Peking. Assuming at that point in time air services to the PRC already exist, or are in fact in the offing, a difficult situation is presented — somewhat reversed from the former — in which the U.S. will be attempting to preserve aviation relations with Taiwan as a “de-recognized” friendly regime whose international status as well as treaty relations with the U.S. will be in doubt. By and large, prospective American commercial and economic agreements with the PRC will face problems of a similar nature.

Under those circumstances, congressional action in one form or another may be expected to resolve the complex legal issues, or in the appropriate case, to implement presidential decisions. In some cases, the President may be given statutory authority to act but he does not necessarily have a free hand. In extending most favored nation (MFN) treatment, and in lowering import duties on Communist bloc nations, for instance, the presidential mandate is fettered by conditions of limitations imposed by the Congress.  

This, however, is not the case when an exchange of commercial rights in international civil aviation is involved. In that situation, from the negotiation of a bilateral agreement pertaining to air transport to final authorization of designated foreign and U.S. airlines to operate the services agreed upon, the President plays a decisive role which effectively puts such matters beyond the reach of the Senate and the Civil Aeronautics Board (CAB). His prowess is derived not only from congressional acquiescence, but also from constitutional and statutory sources.

**Presidential Prerogative in International Aviation**

Under contemporary international law and prevailing national legislation, every nation has complete sovereignty over its air space. Thus far, that has not deterred transnational air travel. In order to facilitate international air commerce, nations met in Chicago in 1944 to work out a multinational solution. Unable to reach consensus on the subject of exchange of traffic rights, the Chicago Convention resolved that no scheduled international air services may be operated over or into the territory of a contracting state without permission of that state. Over a hundred and forty nations, including the United States have signed and ratified that Convention. All have accepted bilateral agreements as standard practice in the exchange of commercial aviation rights. Consequently, the present international air route system of the U.S. is founded on a web of some fifty bilateral civil air transport agreements each of which sets out the kinds of operating rights given, the routes authorized and the mechanism by which rates are determined.

Although the U.S. Constitution and statutes do not specifically define this power and function, the President has always entered into bilateral air transport agreements with foreign countries in his capacity as Chief Executive, exercising his constitutional authority to conduct foreign affairs for the United States. For some time, this practice has been endorsed by the Justice Department, with acquiescence by the Congress. The

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result is that, as executive agreements, air bilaterals are not subject to Senate ratification.\textsuperscript{18}

The President, however, does not simply “rubberstamp” these commercial aviation agreements. While he familiarizes himself with the economics involved by the participation of the CAB, the President becomes involved in the negotiation through the office of the Secretary of State.\textsuperscript{19} Under the Federal Aviation Act, the Secretary is required to advise the Board and the relevant departments heads “... concerning the negotiation of any agreement with foreign governments for the establishment or development of air navigation, including air routes and services.”\textsuperscript{20} By deliberate congressional design, therefore, the Secretary of State and U.S. foreign policy considerations are given a dominant role in the negotiation process; because the Secretary reports directly to the President, the latter is able to maintain effective control.

**FOREIGN AIR CARRIER PERMIT**

This unique presidential mandate in international aviation is complemented by the power of approval of a type of foreign airline permit which the Congress has explicitly entrusted him. Normally, before any foreign airline can operate into the U.S., it must have received prior approval of the CAB.\textsuperscript{21} Such approval may be given in the form of a permit in one of two ways.

To begin with, there is Section 402 *Foreign Air Carrier Permit* which allows the recipient foreign carrier to engage in common carrier operations on a regular basis.\textsuperscript{22} Under the Federal

\begin{itemize}
\item \textsuperscript{16} Convention, Art. 6, *supra* note 15.
\item \textsuperscript{17} Information from Legal Bureau, ICAO, May 1978.
\item \textsuperscript{18} See *Whiteman*, 14 *Dig. of Int’l Law* 221–22 (Washington, DC.: Dept. of State 1968).
\item \textsuperscript{19} Calkins, *Acquisition of Operating Authority by Foreign Air Carriers: The Role of the CAB, White House and Department of State*, 31 *J. Air L. & Com.* 65 (1965); see also Heymann, *The U.S.-Soviet Civil Air Agreement from Inception to Inauguration: A Case Study* (Santa Monica: RAND, 1972).
\item \textsuperscript{20} *49 U.S.C.* 1462 (1958).
\item \textsuperscript{21} Calkins, *supra* note 19; Gillilland, *The Role of the Civil Aeronautics Board in Licensing Foreign Air Carriers*, 32 *J. Air L. & Com.* 236 (1966). The Secretary of State, pursuant to 49 *U.S.C.* 1508(a), may authorize CAAC aircraft to bring U.N. Chinese or its own diplomatic mission personnel to the U.S. solely for that purpose.
\item \textsuperscript{22} Common carrier is a transportation line engaged in the business of handling persons or goods for compensation and for all persons on an impartial basis. In the case of an air carrier, it allows carriage of individually ticketed
Aviation Act, the Board is charged with the responsibility of holding a hearing and determining whether the foreign carrier is “fit, willing and able,” and if the proposed services should be authorized in the public interest. In exercising this authority, it is required to act in a “manner consistent with international obligations assumed by the U.S.”23 In practice, it means that a Section 402 permit is almost always granted whenever a designated foreign carrier applies pursuant to a bilateral air transport agreement. Foreign airlines may, of course, apply for such a permit even though there is no such underlying agreement, or when permission is only sought for charter operations.24

Under Section 801 of the Act, however, Board action on such application (whether it be a denial or otherwise) is subject to presidential approval. Contrary to traditional concepts of administrative legal process, presidential action, in this instance, is expressly exempted from judicial review by virtue of Section 1006 of the Act. Under these conditions, therefore, both the Board and the judiciary have a severely limited role.

The same statutory provisions also enable the President, even in the absence of a reciprocal agreement, to permit a foreign air carrier to operate regularly into the U.S. for foreign policy reasons without fear of subjecting himself to the checks and balances inherent in the constitutional system. As with his control over commercial aviation agreements, the constitutionality of this presidential prerogative has not been successfully challenged.25 In the recent decision of Diggs v. Civil Aeronautics Board,26 the U.S. Court of Appeal for the District of Columbia specifically held that “the clear and unambiguous language in Section 1006(a) . . . of the Act” deprives it of jurisdiction to review an order challenged thereunder on either statutory or constitutional grounds.

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passengers, and advertising itself as a common carrier. In contrast, a contract carrier is any carrier not a common carrier who, under special and individual contracts or agreements, transport persons or property for compensation.

23. 49 U.S.C. 1592. The obligation is on the Board only, and not on the U.S. President.


PERMIT UNDER SECTION 1108(b)

Under the Act, the Board may also issue a more restrictive type of permit which severely curtails the nature, scope and duration of a foreign air carrier's intended operations into the U.S. Generally this permit — known as a Foreign Aircraft Permit under Section 1108(b) of the Act — is issued after a determination of reciprocity, and finding of compliance with public interest and international obligations. While it resembles a Section 402 permit in this respect, it differs from the latter in that it authorizes only nonscheduled and contract (or private) carrier services.

More significantly, here the legislature has seen fit to limit direct presidential control over international aviation. Hence, not only does the Act provide that a Section 1108(b) permit may be issued without the approval of the President, it also affords "interested parties" the opportunity to seek judicial review of Board actions. Under certain circumstances a foreign carrier may prefer a Section 1108(b) to a Section 402 permit if only to avoid an arbitrary and judicially irreversible decision by the President. That will not be the case in the present U.S.-PRC context, however. Indeed, if mutual air services were to become a fait accompli prior to recognition of the PRC, Presidential action through an executive agreement and permit approval under Section 402 of the Act will be crucial. Inasmuch as improved air communication with the PRC is an integral part of American foreign policy toward simultaneous relations with Peking and Taipei, it would require the kind of flexibility and complete executive aplomb which characterize those two legal mechanisms. In one sense, there, too, is where "law" makes way for "politics".

III. U.S.-PRC Air Service Before Diplomatic Recognition

"RECIPROCITY AND INTERNATIONAL COMITY"

Although normally neither the U.S. nor PRC would conclude an air transport agreement with another country in the absence of diplomatic recognition, there is no reason why they would not make an exception for each other in this instance if they consider it politically expedient, and if such an agreement will not hamper

27. Supra note 24.
the reconciliation process. Ideally, of course, the blocked assets problem should have been satisfactorily resolved so that, based on a bilateral aviation agreement entered into by the President, the CAB will routinely make a finding of public interest and approve a Section 402 permit authorizing the Chinese airline (CAAC) regular operation into the United States.30

In the event that an air transport agreement cannot be reached for some reason, the Board may still issue a Section 402 permit on the basis of "reciprocity and international comity" upon CAAC application. Initially, this approach had been adopted by the Board in cases where foreign airlines were seeking entry after underlying bilateral agreements had lapsed. More recently, it has been applied even where there has been no bilateral agreement previously. In his approval of a Section 402 permit to Air Nauru, for example, a CAB Administrative Law Judge specifically observed that there had been no bilateral agreement, and thus "... considerations of comity and reciprocity between the two governments with respect to air transportation matters form the most persuasive single element favoring an award . . ."32

Even on the assumption that the Board acted unfavorably on the application, it will not effectively deter CAAC's entry into the U.S. As previously indicated, the matter ultimately is one of presidential prerogative. The President's power of approval under Section 801 is therefore the final fail-safe.

THE NATIONALISTS UPROAR

Whether or not efforts to revamp the U.S.-PRC air route will come to any fruition before recognition of Peking, the Carter Administration must anticipate strong opposition from the Republic of China. As early as 1970, when the then President of Pan American Airways, Najeeb Halaby, revealed his Company's

29. There are presently no U.S. statutory provisions to prevent such action. Indeed, even a trade agreement with the PRC may be concluded prior to recognition. A trade agreement between the U.K. and the U.S.S.R. in 1921 prior to mutual recognition is one example of international precedent. Note, however, that Whiteman states that the conclusion of a bilateral treaty "... does constitute recognition." 2 DIG. OF INT'L LAW 52 (1968).
30. Whiteman, supra note 24, at 655-58; see also Calkins, supra note 19. CAAC represents General Administration of Civil Aviation of China.
plan to operate to the Mainland "in the immediate future," the Nationalists responded instantly with a vehement denouncement. In particular, the ROC rejected outright any possibility of a U.S. carrier acquiring such operational rights under the 1946 Agreement. Its argument, although not stated explicitly in any official protest to the U.S., was founded primarily on its claim to be the sole legitimate government of China recognized by the United States, and on the Latin maxims of *Pacta sunt servanda* (Agreements must be observed) and *Pacta tertiiis nee nocent nee prosunt* (Treaties are neither of benefit to or detriment to third parties) which are well-established principles of the law of nations.

As a precautionary measure against any Communist Chinese attempts to revive the defunct air link, the Civil Aviation Administration (CAA) of the ROC notified its Ministry of Foreign Affairs to petition the CAB of the United States for an Order to cancel the foreign air carrier permit which had been issued to CNAC (the now nonexistent airline that originally had operated a U.S.-Mainland service but was dissolved by the Nationalist Government as it migrated to Taiwan in 1949). By Order 71-2-80, served on February 17, 1971, the Board directed any interested parties to "show cause" why the Board should not cancel the permit issued to CNAC. Since no objections were filed, the Board acted pursuant to Sections 204(a), 402(f) of the Act, and under Docket 23110 concluded that it was in "the public's interest to cancel" said permit.

The situation seven and a half years later is somewhat different. Now Taiwan is being confronted with a firm conviction shared by both the U.S. and the PRC that renewed bilateral operations will be in their best interest. Consequently, ROC leaders have no doubts that the threat is very real. In desperation, they are expected to invoke treaty provisions and accuse the U.S. of breach of agreement. The Exchange of Notes amending the Sino-American Air Agreement on October 22, 1969 unequivocally stated that: "[r]outes 1, 2, 3 in Section A and B of the Annex to the Agreement shall not be operated without prior consultation and agreement between the two countries." (emphasis added)
Based on this provision, the Republic of China is entitled to be consulted on any U.S. decision to negotiate with the PRC on air services to the Mainland; it would be a violation of treaty obligation on the part of the U.S. if it ventures to reach an agreement with the PRC in the absence of ROC consent.

Additionally, the ROC may interpret any decision by the Board to issue a permit to CAAC (under either section 402 or 1108(b)) for the purpose of initiating a U.S.-Mainland China air service as a contravention of the Federal Aviation Act of 1958. Although under the Act the CAB is empowered to execute those authorizations by following the prescribed procedure, relevant parts of section 1102 and 1108(b) require that: "... in exercising and performing their powers and duties under (this Act), the Board ... shall do so consistently with any obligation assumed by the United States in any treaty, convention, or agreement that may be in force between the United States and any foreign country." (emphasis added) The issuance of either a section 402 or 1108(b) permit to CAAC without observing the provision contained in the Exchange of Notes of 1969 could be considered as "inconsistent" with the Agreement of 1946 and thus a breach of domestic U.S. laws.

THE U.S. POSITION

The Nationalist Chinese position is, nevertheless, undermined by a number of factors. In the first place, in coming to an agreement with the PRC on the exchange of air traffic rights, the United States is acting in accordance with international law and practice. Under the Chicago Convention to which both the U.S. and PRC are signatories, "no scheduled international air service may be operated over or into the territory of a contracting state, except with the special permission or other authorization of that state ..." It cannot be denied that the PRC has sovereignty over the territory for which traffic rights are being sought. But equally important, the governing organ of the Convention — the International Civil Aviation Organization (ICAO) — has formally recognized the PRC as the sole legitimate government representing China. Since the U.S. has acquiesced in this act, it is
only proper for the latter to negotiate directly with Peking on any commercial aviation rights pertaining to the Chinese Mainland.

Secondly, and in theory, careful reading of the 1946 Agreement enables the U.S. to effectively circumvent the key provision in the Exchange of Notes of 1969 which requires "prior consultation and agreement" between the U.S. and ROC on the redevelopment of China routes. It should be pointed out that such rights of consultation extend only to "... route 1, 2, 3 in Section A and 3 of the Annex." Significantly, the traffic points on Chinese territory along those routes include merely the cities of Shanghai, Tientsin, and Canton. Peking, for instance, was not mentioned. This would mean that a U.S.-PRC discussion on mutual air services with Peking as the point of origin or coterminus point would be theoretically outside the ambit of the provision, and hence sufficient to exclude any interference or claims on the part of Taiwan under the 1946 Agreement. Under these circumstances, also, the Board will not be in breach of Section 1102 or 1108(b) for acting inconsistently with U.S. treaty obligations. Even if the Board did violate Section 1102 in a Section 402 proceeding, Section 1006, we have seen earlier on, exempt it from judicial reach.

While this approach may be perfectly legal, it is not necessarily feasible, and possibly not acceptable to either the PRC or ROC for each will deem it an affront to its dignity. Perhaps most important of all, both Peking and Taipei are likely to view such strained interpretation of the Agreement as being unscrupulous and devious of the U.S. Inevitably, it puts U.S. credibility on the line. At a time when problems persist in U.S.-Soviet relations, and in Africa as well as in the Middle East. Washington simply cannot afford to pay the price.

In revamping the China air route, the Administration can only proceed with tact. Given that, however, if an agreement on the exchange of traffic rights can be reached with the PRC which stresses the spirit of the Shanghai Communique while begging the derecognition issue, chances are that Taiwan will accept it although only grudgingly. To the extent China Airlines' invest-

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Government of the United States does not recognize the so-called People's Republic of China... and therefore it regards... adherences to this Convention as being without legal effect and attaches no significance thereto.” This footnote has been deleted in TREATIES IN FORCE (1977) and (1978).

ments and revenue are heavily U.S.-centered, and there are no effective means to stop the Americans from initiating bilateral air services with the Chinese People's Republic and from travelling to Taiwan, (if necessary, via non-U.S. airlines) Taiwan is clearly not in a strong bargaining position vis-à-vis the U.S.

IV. Problems and Perspectives After Recognition

DIPLOMATIC RECOGNITION OF PEKING

The foregoing situation, of course, would have been different, and the arguments therein inapplicable if the U.S. had extended diplomatic recognition to the PRC. Insofar as the latter is concerned, the issue of diplomatic recognition has always played a tacit but significant role in its civil air agreements. A survey of the official treaties of the PRC reveals that it has not yet signed an agreement of this nature with a nation with whom it has no prior diplomatic or even consular relations. It is therefore quite possible that the Chinese would follow the rule rather than the exception when it comes to such an agreement with the U.S. prior to recognition, unless, as indicated previously, they find it so politically expedient that they decide to deviate from established practice.

Diplomatic recognition of Peking, however, has other significance in the present context. To begin with, formal recognition of the PRC would have necessitated an early settlement of the blocked assets and private claims issues to mutual satisfaction. More important, the extension of de jure recognition to the PRC would result in its withdrawal from Taiwan. One view is that the legal effect is to restore the island Republic to the PRC, and render all its previous treaties and agreements with the U.S. inoperative. It also follows that the 1946 ROC-U.S. Air Transport Agreement would lose its legal meaning and effect. In that case, there need be no squabbling over the interpretation of the 1946 Agreement and the Federal Aviation Act as it relates to the re-establishment of U.S.-China air services. The U.S. and PRC presumably would negotiate a new agreement.

STATE SUCCESSION IN INTERNATIONAL LAW

Another view is that the present Chinese government — the PRC — is bound by the principle of “state succession” in

38. Only in one case did the PRC conclude an air agreement with a country with which it had only consular relations — with Laos in 1962.
international law to honor and abide by a bilateral agreement entered into by a predecessor government. The notion is based, in part, on a distinction drawn by some Western legal scholars between a new "government" and a new "state." The idea is essentially that a newly created "state" inherits neither the benefit nor the burden from a former state. Instead, it begins with a "clean slate." The opposite is true of a new "government" which exists under the same "state," and the PRC can fall into that category. So the argument is this: Admittedly, the government did change hands in 1949 but, arguably, it has not affected China's international status and its rights and obligations as a sovereign "state." Thus, as the succeeding government, the PRC inherits previous commitments of the state.

O'Connell, the prominent Australian jurist, came to a similar conclusion favoring "state succession" by virtue of a "continuity" or status quo approach. In his opinion, change of sovereignty in practice has little effect on subsequent air policies. The new government normally continues to extend to the other country commercial traffic rights under the original bilateral agreement, although very often a new agreement and new permits are negotiated and issued at a later date. O'Connell ultimately concludes that "there has therefore been almost universal continuity of air transport agreement[s], enduring for at least the period normally covered by termination." 40

Taking either one of the preceding two views on "state succession," it would seem that international law, after all, does provide an answer to the present problem. As definitive as these views may have been, they have outlived their heyday inasmuch as they oversimplify the political forces, cultural values and developmental experiences which have brought about the change of government in the first place, and the emergence of many new nation-states in the recent decades. Moreover, those views can only thrive on the logic and assumption that rules and precedents of international law will be determinative, or followed in a like situation today. In reality, of course, one can only hope that it be so. In the absence of effective sanction, international law can only be


what nations make it out to be; because of the changing times and the diversity in identity, interest and ideology among world nations, there can only be but different views and acceptance of these principles. The PRC's perception, in this regard, is deeply influenced by bitter experiences of the past, and its resultant conversion to Marxist-Leninist ideology. Adopting a very utilitarian concept of law in general, the PRC looks upon international law essentially as an instrument in reaching the optimum in a given problem situation. 41

**CHINESE PERSPECTIVES OF “SUCCESSION”**

In dealing with the question of whether under international law, it should be bound by treaty and international obligations of the pre-revolutionary government, for instance, the People's Republic of China has felt it best to reserve its options. Accordingly, Article 55 of the Common Program of the Chinese People's Political Consultative Committee, which was promulgated in 1949, declared, *inter alia*, that the "... Central Peoples' Government of the People's Republic of China must study the treaties and agreements concluded by the Kuomintang (KMT) government with foreign governments, and depending on their contents, recognize, abrogate, revise, or renew them." 42 (emphasis added)

Despite the lack of a general hard and fast rule in determining the validity of agreements concluded by the Nationalist Government prior to 1949, however, it can be safely predicted that the PRC will not act favorably toward any alleged rights and obligations arising from the Air Transport Agreement of 1946.

First of all, the Central Committee of the Communist Party has asserted in a statement on February 1, 1947 that the People's Republic would not bear "any obligation for any... treaties [or]... agreements of understanding" entered into by the Nationalist Government which would "disgrace the country and strip it of its rights." According to this statement, "form[ation] of treaties regarding special rights in commerce, navigation, aviation, and other special economic and legal rights" would be included.

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41. For the PRC's attitude towards international law in general, see Hsiung, Law and Policy in China's Foreign Relations, (1972).
The rationale behind this declaration is twofold. Basically it was a formal act on the part of the revolutionary government to denounce the Nationalists as the “corrupt and delinquent” regime which had been “selling out” China to aggressive Imperialists. The Central Committee was making references to a series of treaties and agreements which were concluded between China and various foreign powers in 1946. Clearly, the 1946 Air Transport Agreement with the United States was included among them, although the U.S. Department of State had indicated that it merely regarded it as a “purely commercial aviation” agreement which made “no provision for base rights for either government in the territory of the other.”

The other rationale is somewhat related to the first; it stems from the PRC’s intense dislike of “Unequal Treaties.” To the Chinese, unequal treaties are remnants of a humiliating past which “undermine the most fundamental principle of international law — the principle of Sovereignty — and therefore they are illegal and void, and states have the right to abrogate this type of treaty at any time.” As one PRC writer on trade and international agreements wrote: “Whether or not a treaty is equal does not depend on the form and words of various treaty provisions, but on the state character, economic strength, and the substance of the conditions of the contracting states.” Following this line of reasoning, “unequal” treaties would include not only the classic agreement signed under duress, or “at gun point,” but also one in which political and economic factors were not given due consideration. Based on this assertion, it is possible that People’s China may condemn the 1946 bilateral air agreement as an “unequal treaty” since its legality is vitiated by the disproportionate political, economic and aviation strength of the parties involved at that time, even though traffic rights were seemingly exchanged on a reciprocal basis and there was no evidence of actual coercion.

43. References quoted in Steiner, The Mainsprings of Chinese Communist Foreign Policy, 44 Am. J. Int’l L. 93 (Jan., 1950); see also Cohen and Chiu, II China’s Practice of International Law 1121 (1974).
44. United States Relations with China, with Special Reference to the Period 1944-1949, at 224-25 (U.S. Dep’t of State, 1949).
Secondly, the terms of the 1946 Agreement constitute in themselves a strong deterrent against adherence by the PRC. In order to shield its relatively new carrier from unlimited interline competition, the People's Republic has generally subscribed to a "restrictive" international aviation policy in its bilateral air agreements.\(^{47}\) In addition to being state-run, the Chinese airline — CAAC — has adopted such means as predetermination of capacity and frequency, and strict governmental monitoring of tariffs to control its markets. For the PRC to accept the original Sino-U.S. Agreement containing virtually all the liberal principles of the "Bermuda Conference" (which provides for ex post facto review of capacity by individual carriers, and IATA (International Air Transport Association) as rate-setting machinery) would be to forsake the basic ideological and economic themes which underlie its policy and practice in international air transport.\(^{48}\)

The 1946 Air Transport Agreement also furnishes the United States with "...[r]ights of transit and nontraffic stop in Chinese territory, as well as the right to pick up and discharge international traffic in passengers, cargo and mail at Shanghai, Tientsin, Canton (and Peking on a temporary basis) as well as at such additional points as may be agreed upon from time to time" on three separate Pacific and Atlantic routes. (emphasis added) In addition, "United States carriers will be authorized to serve additional traffic points in Chinese territory as soon as the carriers of any third country are so authorized. . . ." (emphasis added)\(^{49}\) Both of these provisions — one enabling extensive route concessions and the other an "MFN" clause in aviation rights — are unprecedented in PRC practice. They will not be any less objectionable after recognition by the U.S.

**ROC after Derecognition**

As previously indicated, derecognition of ROC also brings into focus the problem of maintaining its present air link with the U.S. If recognition of Peking has the effect of annulment on the

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\(^{48}\) The PRC is currently considering membership in IATA. It is especially interested in the Clearinghouse arrangement.

\(^{49}\) Exchange of notes on December 20, 1946, Paragraph (d), *supra* note 4.
U.S.-China Air Agreement of 1946, what, then, is the legal basis for continuing aviation relations with Taipei? Since Article 6 of the Chicago Convention stipulates that "no scheduled international air service may be operated over or into the territory of a contracting state without its special permission . . .," will the U.S. be so obligated to directly negotiate with Peking?

The answers to these questions are by no means clear, and at best, conjectural. Quite obviously, the U.S.-PRC-Taiwan scenario is unique and was not originally contemplated or foreseen when the Chicago Convention, or when the traditional concepts of state succession and recognition came into being. In reality, also, there are no legal precedents governing the present situation. Arguably, one can therefore be pragmatic and innovative in resolving the issues at hand.

At the outset, there is no reason (if sound in policy) why the U.S. cannot legally extend a limited form of recognition to Taiwan subsequent to establishing formal diplomatic relations with Peking. It is possible that as long as the Nationalist Government is in de facto control of Taiwan and its population, and still engages in foreign relations, the island may be deemed to have acquired an independent international legal existence. From the U.S. point of view, this would be the realistic approach. To Washington, the "form" in which Taiwan then may choose to exist is not particularly important; and its independent existence need not be specifically defined. Rather, it is more important, for present purposes, for the U.S. to stress the concept that although Taiwan cannot legally represent China Proper, it can be viewed technically as an entity in its own right, within its own geographical limits and area of competency. On this premise it necessarily follows that, in order to obtain air traffic rights into Taiwan, the U.S. will have to approach Taipei and not Peking.

In so doing, the U.S. will also be acting in a manner consistent with the Chicago Convention of 1944. It is not disputed

50. Although a similar situation existed when Japan and the PRC concluded an air agreement in 1974, neither side specifically invoked legal principles stemming from the Chicago Convention. Previously, Japan only had a provisional commercial air agreement with Taiwan.

51. This view is endorsed in the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 4 (1965); see also Convention on Rights and Duties of States, Montevideo, December 26, 1933, 49 Stat. 3097, 16 L.N.T.S. 19. Article 1 of the Convention specified similar qualifications for statehood.

52. This is within the spirit and language of the Shanghai Communiqué. Being deliberately vague and open, it avoids unnecessary complications.
that Article 6 does require special permission or authorization of the contracting state for scheduled flights over its territory. However, the Convention has defined territory to be “... the land areas and territorial waters adjacent thereto under the sovereignty, suzerainty, protection or mandate of such state.” (emphasis added) Further, pursuant to Article 1, every state has complete and exclusive sovereignty only over the air space above its territory. Since it is Taiwan’s territory and air space that are in question, and the PRC strictly does not have effective control nor sovereign rights over it, the U.S. need not obtain permission from Peking for air traffic rights to and from the island state.

The fact that after the Nationalists retreat from the Mainland the 1946 Air Transport Agreement had been modified to apply exclusively to the territory of Taiwan raises another interesting possibility. Since both parties evidently had intended the Agreement to apply only to Taiwan, it may be argued that no subsequent change of government or recognition can affect its continued application. Indeed many international jurists, including Lord McNair, share the opinion that withdrawal or severance of diplomatic recognition does not affect treaty relations between the two parties. According to this view, a mere political act or gesture of policy like recognition cannot put asunder an agreement which is in essence a mutual manifestation of the desire to be bound in a legal relationship. In the same vein, another view suggests that, as a sheer political act, diplomatic recognition should not affect non-political relationships. Arguably the ROC-U.S. air link is one such relationship.

If either one of these views is adopted, then, in theory, the Taiwan air route and the legal framework within which it operates would remain at status quo after recognition of Peking. In practice, however, the PRC may not tolerate such an approach. It may insist, for example, on the “Japan formula” in which case U.S.-ROC air services can only be conducted on a private and contractual level. This, in fact, is the current state of affairs in aviation relations between the PRC, Japan and Taiwan.

54. See also Oppenheim, I INTERNATIONAL LAW 939 (8th ed., 1955); see Restatement § 98(2), supra note 51.
55. Li, supra note 13, at 33.
56. Currently Taiwan's China Airlines and a Japanese company, Japan Asia Airways, operate the Japan-Taiwan route. CAAC and JAL now serve the PRC and Japan.
Whether it be the 1946 agreement as amended, or a completely new agreement or the “Japan formula” for Taiwan, the U.S. is likely to find the “balancing” act between Peking and Taipei both difficult and challenging. If infuriated by an indiscreet American move, the ROC government may risk its U.S. services and deny access and flight information to all U.S. airlines operating through its Flight Information Region (FIR) just as they had done to the Japanese in 1974.\textsuperscript{57} As a result of such ROC action, JAL promptly lost ten percent of its revenue from its total international operations that year. In the case of the U.S., the potential for loss is all the more greater considering that apart from the voluminous passenger traffic, the value of air freight between the two countries is expected to increase roughly fifty-five percent from $1.1 billion to $1.7 billion in the next five years.\textsuperscript{58} As in the Japanese case, success depends on U.S. resourcefulness and its ability to reach a delicate compromise within a trilateral political framework. The difference is that the roles of Peking and Taipei would be switched, and more ROC ego and emotions would be involved. In either case, however, problems in coming to terms with both sides will reach beyond the realm of politics and law. For the PRC, this is partly attributable to the fact that as a socialist planned economy and a late-comer to commercial aviation, it has a very different infrastructure and concept of regulatory economics in international air transport from that of the U.S.

V. Conflict and Compromise

DIVERGENT APPROACHES

Because air transportation in the People’s Republic has a small market, and is owned and monopolized by the state, competition in the private enterprise sense simply does not exist.\textsuperscript{59} Conversely, as it is also neither experienced nor equipped to compete with major Western countries in the contemporary airline

\textsuperscript{57}See Central Daily News (Taipei), June 6, 1973, April 17, 1974. The Civil Aviation Administration of Taiwan is responsible for air navigation services within the Taipei Flight Information Region (TFIR). Established initially through the Chicago Annexes and ICAO, TFIR covers an air space of 176,000 sq. nautical mls. At present it includes 14 airways.

\textsuperscript{58}George Zettler, Vice-President (Sales) of Flying Tiger Line (August 1978) (Joint Economic Meeting of the U.S. and the ROC).

\textsuperscript{59}As between regional bureaus, however, there could be competition in meeting the state plan.
market, the PRC adopts a “protectionist” as opposed to a “laissez faire” approach abroad in which the state maintains a tight control over traffic rights, capacity and tariff. In fact, as many as twenty-three of the thirty-plus civil air transport agreements entered into by the PRC are characterized by provisions for predetermination of capacity and government supervision of tariff. The Chinese obviously believe that state participation in planning and decision-making in these respects, and close cooperation between the two parties to the agreement can equalize disparate competitive bargaining power and avoid otherwise risky airline initiated experimentations, thereby guaranteeing a fair and constant return from the designated air routes.

On the other hand, with a well-developed market at home and overseas, the U.S. is free enterprise and consumer-oriented, and generally favors a competitive environment for air transport. The traditional American philosophy is that airline competition is healthy since it increases efficiency and lowers costs. The end product is, therefore, cheaper rates and better service for the public, and improved safety and technical benefits for air travel as a whole. Also, the Americans favor an accident compensation limit which is many times higher than that set forth in the Warsaw Convention (1929) as amended by the Hague Protocol (1955) to which the Chinese adhere. In the face of these fundamental differences, U.S. attempts in reaching a mutually acceptable agreement can only lead to a conflict. The American task is made even more difficult by the precedent which was set by its agreement with the Russians in 1966, and with the British (better known as Bermuda II) less than a year ago. Like the PRC, neither the Soviet Union nor the United Kingdom believe in a liberal policy in bilateral air commerce.

U.S.-Soviet Agreement (1966) and Bermuda II (1977)

Although the two agreements are a decade apart from each other, they are similar in nature and relevant in this context

60. Typically, the General Administration of Civil Aviation negotiates directly with the foreign airline. Capacity and tariff provision are subject to its final approval.

61. That is solely because only the contents of these twenty-three agreements have been unearthed and studied. It may be assumed that the remaining ones do not deviate from the pattern.


because the U.S. in both instances adopted a basically “restric-
tive” approach to international air transport.\textsuperscript{64} At one level, this
furnished an example of the kind of consensus which may be
achieved between systems which pursue differing aviation
policies. At another level, however, it also opens up the Pandora’s
Box in U.S. aviation negotiations with not only the People’s
Republic, but with such countries as Japan and Italy as well.
Having previously agreed to predetermination of frequencies and
limitation of fifth freedom rights with the Soviet and United
Kingdom, the U.S. cannot lightly refuse the same concession to
the People’s Republic lest it be accused of discrimination.\textsuperscript{65} But if
the U.S. makes another exception for the PRC, it will be
constrained to either doing the same or making economically
detrimental route concessions as a substitute in its present
negotiations with Japan and Italy.

In either case, the choice will be a very difficult one. Should
the U.S. agree to a repeat performance for the PRC it will run
afool of the Administration’s rationalization of the Soviet and
British agreements as “special cases.”\textsuperscript{66} Moreover, without
seeking adequate concessions from Peking, opening up the China
air route can be considered by some as being counter-productive in
balance-of-payment terms. Indeed, it was concern for this “give-
away” attitude which prompted then President Nixon a few years
ago to warn in the \textit{Statement of International Air Transportation
Policy} that “... caution must be exercised in granting routes on
which the traffic potential is limited. ...” Echoing a similar
concern for the imbalance of traffic on some international routes,
the CAB has also cautioned that the U.S. should “... trade as
equals, not as the dominant giant and the less well-off countries.
After a while, our generosity catches up with us ...”\textsuperscript{67}

Assuming that an agreeable arrangement with the PRC is
ultimately reached, an additional problem still exists. Economic
realism dictates that the U.S. secure “beyond rights” from

6135 as amended. T.I.A.S. Nos. 6560, 7658, 8058. Air Transport Agreement. July 23,

\textsuperscript{65} High level U.S. officials have made known that they will not adopt
Bermuda II in future negotiations, \textit{see} Aviation Daily, October 3, 1977. The Soviets
have also created many problems after the bilateral air agreement was put into
effect. Among other things, the U.S. has accused Aeroflot of engaging in deceptive
practices. \textit{See} Order 76-10-79 issued on October 19, 1976 (Docket 29944).

\textsuperscript{66} Possibly, an exception was also made in the agreement with India.

\textsuperscript{67} 36 \textit{J. AIR L.} & \textit{COM.} 651 (1970).
gateway cities of Tokyo and Hong Kong ahead of time. If not, then, like the case of Canada, air traffic rights to China will remain a dead letter. Meanwhile, in seeking these “beyond rights,” the U.S. would be put in an unenviable bargaining position with Japan and the U.K. Possibly, route concessions may have to be made in both cases.

VI. Some Afterthoughts

Thus far, an attempt has been made to analyze the legal technicalities and problems of commercial aviation within the U.S.-PRC-ROC framework. Although some conclusions have been reached in support of simultaneous services to both the Chinese Mainland and Taiwan, they nevertheless merely represent an optimism which can easily be shattered amidst the vicissitudes in U.S.-PRC relations, and recurring problems within the People’s Republic itself. Unfortunately, because of the novelty of the trilateral relationship, and its lack of effective sanction, international law cannot be outcome determinative in this case. Rather, the solution to the trilateral problem and its viability depend to a large extent upon the resourcefulness and decision-making power stemming from one person, namely the American president. In this respect, therefore, the situation is unique.

From a practical point of view, though, the problems and solutions explored in the context will serve as a meaningful reference for other countries and airlines contemplating capitalizing on the current “China craze.” While their enthusiasm may yet lead to the emergence of a new international air route structure, they will no doubt find, as Marco Polo did years ago, that the road to China is a much more difficult one than one would anticipate. In the long run, since the PRC air route is not likely to be profitable in the foreseeable future, a foreign airline may be constrained to make a realistic choice between “pride” on the one hand and “purse” on the other.

By virtue of an agreement with the U.S., the PRC will be moving further along in its integration with the existing norms in international air transport. In terms of the development of its air routes abroad, CAAC will be able to activate “beyond rights”
obtained from Japan and Canada to the U.S. and beyond to Latin America. Additionally, the relatively inexperienced Chinese will benefit from aviation-related legal and technical interface with their American counterpart. The outcome, of course, will be supportive of Peking’s present pragmatic foreign policy, and its recent decision to open its doors to visitors from overseas.

As far as Taiwan is concerned, ever since the PRC Japan air agreement came into being, it has reluctantly but quietly accepted the “Japan formula” as the means in preserving aviation relations with derecognizing states. This study has suggested an alternative to that approach; that is, given some form of independent international legal existence, Taiwan can, at the very least, benefit from the Chicago Convention although it is not a party to the treaty itself. Since this has the effect of placing its aviation relations on a state-to-state level, it would seem a better option for Taiwan in future similar situations than the “Japan formula” which can always remain its very last resort.

Certain questions about the PRC, however, remain unanswered. An especially pertinent one is whether or not it has, or is able to produce the necessary technology and equipment to sustain CAAC’s growth and its ambitious development schedules at home and abroad. Also, can China’s burgeoning tourism industry thrive by “walking on two legs” without seeking foreign expert help? If not, will the Chinese on the Mainland import it

70. As a state, Taiwan in theory may ratify the Chicago Convention and join ICAO.
71. There are varying estimates on China’s civil air fleet. The most recent one was made by Bohdan Szuprowicz of 21st Century Research. See Szuprowicz, China’s Airline Program Still Modest, But Growing, AIR TRANSPORT WORLD 38–42 (May 1978). Out of the approximate total of 600 aircraft in his estimation, 287 are Soviet-made. An earlier figure was made available by Hans Heymann Jr., then of Rand Corporation. According to him, the total number of civil aircraft acquired and ordered was 500 by September, 1974. Among them, 390 are Soviet models. A 1971 estimate provided by intelligence sources in Taiwan was a total of 340. The conclusion based on these figures is that between 70–80% of the Chinese civil air fleet are Soviet-built, piston-driven or turboprop aircraft. Within the air fleet, also, only 15 have a range beyond 3,500 miles. At present, the aircraft factories in Shenyang, Chungking and Harbin, and the design and development centers there and in Peking, are still not meeting the nation’s demand. Moreover, it is estimated that China will have to upgrade up to 50 airports to develop a modern air system. Id.
from the U.S.? Granted that they will, what then will be the mode of technology transfer? Are there constraints on their choices? If so, what could be the inhibiting factors?

At first sight, one must concede that, individually, they present some very difficult questions. Nevertheless, taken together and upon further reflection, a common discernible premise or pattern among them readily emerges. Underlying all these questions is the basic tenet and problem that People's China as well as its civil aviation are going through a transition. Most importantly, whether it be a society or an industry, when it is involved in such transformation from a traditional era toward modernity, there will normally be impediments to constructive changes. In this regard, the PRC and its civil air transport industry are no exception.

Generally speaking, in aviation, apart from the demand for better management concepts and personnel, the need is vital to maintain a modern fleet of aircraft and high technical standards in flying, maintenance, overhaul and inspection, as well as navigation and communications. In the PRC's case, however, it goes even beyond that. As its representative rightly pointed out in a recent ICAO meeting, the problems it confronts and shared by the developing countries are different from those which developed countries now face.

. . . For example, while the development of a new type of aircraft and the advent of a new generation of air transport would provide new orders for the manufacturing states, to China and the developing nations it would mean having to go into re-equipment before the life-span of their present air fleet expired. On top of that, there are problems of financing and spare parts acquisition for these foreign-made aircrafts.

Needless to say, the Chinese on the mainland are cognizant of their needs and the importance of modernization. They certainly would like to be able to develop an independent and viable aircraft industry, and to build their domestic and international airline on their own. It is only that, at this time, they lack the ways and means to accomplish these objectives.72 What is more, the People's Republic is fearful and uncertain of the price it may have to pay to

72. Heymann, for instance, suggests that the Chinese are at least 20 years behind the West in aircraft technology. See supra note 41.
keep in step with progress. To a large extent, as impediments to growth, this fear and uncertainty is attributable to China's experience with foreign involvement in its civil aviation development both before and after 1949.\(^\text{73}\) To be able to properly appraise the present Chinese aviation market, it is absolutely necessary to trace and closely examine those developmental experiences. With better understanding of their current implications and significance to the Chinese, interested U.S. airlines and aircraft manufacturers can develop the proper strategy, and avoid many of the illusions and pitfalls here and now, thereby improving their chances of successful dealings with the PRC.

Two additional comments, however, need be made about this second portion of the study. First, as previously mentioned, historical considerations are in order. Marking the change of government on the Chinese Mainland, the year 1949 will serve as the dividing line in our chronology and concentration. In discussing the pre-1949 period, the focus will be on local aviation joint ventures with the U.S. Although there were similar undertakings with other countries during that time, none lasted as long, cost as much and became so entangled with Chinese civil aviation as the Americans. The latter, of course, also made the most impact on the industry. As the discussion shifts to the period after the Communist takeover, however, the emphasis is on the Soviet Union. To the extent that it was the only nation that ever became involved with air transport growth in the People's Republic at that point in time, its experience will be extremely relevant to the present analysis.

Second, in assessing the business outlook for U.S. airlines and aircraft manufacturers in the PRC, no effort has been made to examine the legal problems inherent in further normalization of bilateral trade and economic relations. It is presumed that, in time, presidential action and legislative changes will overcome the existing obstacles. Instead, toward the end, this study concen-

trates on the areas of possibility in civil aviation, and the means of realizing that possibility. In particular, it probes the feasibility of joint venture, licensing and service contracts within that setting.

As used throughout this study, the term "joint venture" includes various cooperative arrangements and is not necessarily limited to equity joint ventures.
PART TWO

THE PRC MARKET — PROBLEMS AND PERSPECTIVES FOR THE U.S. CIVIL AVIATION INDUSTRY

... The U.S.A. and reactionaries of certain other countries do not let us progress, do not let us become powerful... we are filled with anger... But let them wait eight or ten years or a little longer, and then they will see what China is...

People's Daily, Peking August 13, 1960

I. American Pioneers — The Turbulent Years (1928-1948)

THE CASE OF THE CHINA NATIONAL AVIATION CORPORATION (CNAC)

In the early twenties, Charles Lindbergh's historic flight had not only tickled the fancy of many people, it had created considerable impact on aircraft production and, in turn, the stock markets on Wall Street. Consequently, U.S. investment speculators began to take great interest in aviation-related market opportunities abroad. Prospects were investigated in Cuba, Peru and Turkey. It did not take long for an affiliate of Curtiss-Wright to notice the vast possibilities that the field of air transport offered in China. Encouraged by the Chinese and the American government, the company — Aviation Exploration Inc. — decided to investigate the potentials seriously. Their efforts were well rewarded, for in 1929 they came to agreement with a government-sponsored aviation corporation in China. Thus far, the path to the East had been smooth. As it were, the Americans became the first foreigners to help the Chinese develop their commercial airlines.

Initially the parties resolved to enter into two contracts. The first was an unprecedented mail contract over certain exclusively franchised routes in China. In return for air and ground support services furnished on these designated routes, Aviation

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74. LEARY, THE CNAC, supra note 73, at 6. Soon, as in China's case, Pan Am and Lufthansa were competing against one another to gain a foothold in Latin America. Burden, Struggle for Airways in Latin America, (New York: Council on Foreign Relations, 1943).

75. The first two agreements were originally published in 13 CHINA SOCIAL AND POLITICAL SCIENCE REVIEW 81-91 (Public Docts. 1929). The third contract is found in Arthur M. Young Papers, Hoover Institution. Young was financial advisor to the Chinese government during the critical years 1929-47. He also served as Director of CNAC.
Exploration, and later its successor China Airways Federal, was to be paid by a combination of postal receipts and promissory notes at a per-mile rate based on a sliding scale and a minimum guarantee of 3,000 miles per day. The other contract granted the U.S. corporation the right to establish and operate flying schools, and the privilege of "engaging in all usual branches of the commercial aviation industry, including the purchase or sale or repair of airplanes . . ." It is interesting to note that even though both contracts had been signed in 1929, they each had a Chinese and English version, and displayed comprehensive draftsmanship and features comparable to the contracts of today. For instance, there were clear provisions regarding legal liability, taxation, arbitration and assignment of contract.

Three months later, in order to obtain financial support for the construction of airports necessary for the contemplated air services, Aviation Exploration also agreed under a third contract to loan the Chinese company U.S. $1 million in gold coins at an interest rate of six percent per annum payable semiannually. No joint venture had existed at this point. However, the scenario changed the following year as the Chinese corporation underwent complete reorganization.

Under a Sino-U.S. joint venture agreement in 1930, a new company named China National Aviation Corporation (CNAC) was formed in China with an authorized capital of approximately U.S. $3 million divided into 10,000 shares at U. S. $300 par value each. The new contract called for the dissolution of the previous contract, and a consolidation of all the assets and liabilities of the Chinese and the American company in China into the new venture CNAC. This time, for a forty-five percent ownership of CNAC, the U.S. partner delivered U.S. $25,000 in cash, in addition to other equipment and assets it turned over at book value.

As to be expected, even with their majority interests, the Chinese were anxious to control the company. Under the agreement

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76. Air Mail Contract Between CNAC and Aviation Exploration, Inc., Articles 4, 10, 12, 20, China Social . . ., supra, note 75, at 85-89.
77. Contract between CNAC and Aviation Exploration, Inc. for Establishment and Operation of Flying School, Factories and Aerial Transportation, Article 1. Id. 81.
78. The Six Percent Gold Loan Agreement, Article I, Section 2, and promissory note as part of contract, Young Papers.
79. Young Papers, Contract between Ministry of Communications, ROC and China Airways Federal, Inc., U.S.A., Articles II, IX.
the Chinese could appoint four out of seven members of a Board of Directors responsible for the management of the jointly-owned corporation. It was also agreed that the highest executive officers, namely the president and one vice-president of CNAC, were to be selected by the Nationalists Chinese government. In the same spirit, two of the operating divisions — Business and Finance — of the new airline were to be headed by Chinese citizens with American assistants. Although the American share of ownership of CNAC passed to Pan Am three years later, the above predominantly Chinese arrangement remained substantially the same until 1945. By that time CNAC was operating eight routes and carrying some 40,000 passengers — 180 times the total fifteen years ago. In that year Pan Am sold its CNAC shares back to the Chinese government, and entered into a new agreement with the Chinese for setting up a new CNAC in which it acquired only a twenty percent ownership. In spite of the many organizational changes in the Sino-U.S. airline venture, American interests persisted right up to the last days of the Nationalist rule on the Mainland. While there were similar cooperative arrangements with Germany (Lufthansa) and the Soviet Union before 1949, they could not match CNAC in terms of the extent of their activities and involvement in the development of civil aviation in China.

AIRCRAFT MANUFACTURING

Prior to the Communist takeover of China, U.S. capital and management participation also prevailed among the local aircraft
and parts manufacturing industry. Even though as early as 1920 China had produced its own glider trainer, aircraft manufacturing on any noticeable scale was lacking owing to the apathy of the investment public, insufficient government encouragement and training facilities, as well as a general scarcity of indigenous aeronautical technology and aircraft parts. By 1937 however, there were at least three joint ventures in aircraft manufacturing in China, two of which were co-owned by U.S. partners. The major Chinese-American aircraft factory operated in Hangchow under a five year agreement with renewable options. It was producing body framework for some sixty aeroplanes every year. Here, notwithstanding that it had been mutually agreed that the Chinese would be running the entire management and production in the long run, all business, finance and operational functions were headed by the American counterpart for a number of years.

For their earlier triumph with the joint airline venture CNAC, Curtiss-Wright of the U.S. was given the permission to help build the second aircraft factory in China. It was located in Canton and had a manufacturing capacity of four airplane body frameworks per month. The third and only other compatible foreign investment in this industry came from the Italians. In addition to their contribution in military aviation, the latter were successful in persuading the Chinese to set up, under joint capital, an aircraft factory in the South. By 1937, this factory was turning out ten aircraft in a month.

A MIXED BLESSING?

So far history speaks for itself. American investments indeed played a dominant and meaningful role in the development of civil aviation in pre-1949 China. From their U.S. airline partner Pan Am, the Chinese were able to reap the benefit of strong financial support, valuable experience, better and more efficient operating procedures and management concepts. Without the skills, dedication and preserverance of some of the flight and ground personnel furnished by the American co-owners, life sustaining air operations for most parts of China during the Japanese attack would have suffered a

complete breakdown. Similarly, had it not been for the technology, capital and entrepreneurship of its U.S. counterpart, China could not have singularly afforded any aircraft and parts manufacturing facilities. Yet it would be presumptious to measure the success or failure of these joint ventures and their relevance to China today by these facts alone. While China and its foreign partners were obviously motivated and bound together by mutual self-interest in these undertakings, there were many misgivings on both parts. To the extent that these misgivings represent perspectives of business partners with very different economic, socio-political and historical backgrounds, they demonstrate the propensity of recurrence, and the need for changes and compromises today and in the future. For this reason, and in attempting an objective appraisal of the aviation joint ventures, these misgivings must be carefully analyzed.

On the Chinese side, the basic problem had been the strong anti-foreign sentiments among both official and civilian circles since the late Ch'ing period. While the usefulness of air transportation was not disputed, the public, and even those who advocated import of foreign technology into China for the purpose of modernizing the economy still carried fresh and vivid memories of the humiliation the country had suffered under foreign economic domination. The concession of extraterritoriality, the most favored nation treatment and the loss of inland navigation rights were painful thoughts which continued to haunt the Chinese mind. That as a practical necessity the country had to rely on foreign capital, technology and management in the development of the aviation industry was a fact that many Chinese found difficult to accept. The result was to put the joint aviation ventures in a very unfavorable operating environment from the very start.

Fear of foreign domination might have been eliminated or minimized through the assurance of an overwhelming Chinese interest in each joint undertaking. With this in mind, the Chinese in the beginning had insisted on, and succeeded in obtaining a fifty-fifty percent majority in their contract with the Americans. When the Sino-U.S. agreement establishing a joint airline was announced in 1930, it was warmly received by the local press and was acclaimed as one of the significant achievements of the

86. YOUNG, CHINA AND THE HELPING HAND 1937-1945, at 52-54 (1963); LEARY, DRAGON'S WINGS, Chapter 4, supra note 73. In fact, since 1933, Pan Am had given CNAC the full use and benefit of its Purchasing Department in the U.S. Equipment orders were made by CNAC without requirement for down payment, and savings ranged from 10-40%. CNAC Memo, Pan Am Records, at 2-3.
Nationalists government. Unfortunately, the guarantee of Chinese control under these majority equity interest arrangements proved to be more apparent than real as foreign partners remained in charge of operations. So long as the latter continued to supervise services, they were in a position to retain effective control over the sole marketable product of the airline, and thus its revenue. The "Chinese majority" rule as a model for future emulation also turned out to be short-lived. In the late thirties, when the Nationalists Chinese government reached agreement with the Soviets in opening a joint airline, they were compelled by pressing circumstances to concede to equal ownership by both parties. This became a new precedent which survived despite the change of government in 1949.

The other major Chinese complaint was that the foreign partners had not made sufficient efforts to train local pilots and ground personnel as they had originally promised. In addition, there was proven discrimination in the payment of wages to qualified Chinese flight personnel. Discontent also existed in joint ventures in aircraft manufacturing. In this field, the acknowledged goal was ultimate self-sufficiency; yet in the years to come the Chinese were unable to break away from complete dependence on their foreign partner for know-how, designs and aircraft parts. In 1936, while its purchases of aero-engine parts and products from the U.S. totaled $6.9 million, China was also simultaneously importing a substantial number of aircraft from other nations. That being the case, what did the jointly-owned and operated aircraft factories in China accomplish?

Evidence shows that at the initial stage, a typical joint aircraft production venture would be engaged exclusively in the importation of parts and construction of simple aircraft body frameworks. The factory would only enter into aircraft production at a much later stage; and even when it did, it would merely manufacture "second rate" aircraft of foreign design. Input from the host country in all areas except labor was actually very

88. The post-1949 Sino-Soviet airline SKOGA was equally owned by both sides.
89. Young, China Nation-Building, p. 324.
90. Leary, Dragon’s Wings, supra note 73 at 198–200.
limited. Consequently, China’s early hopes of self-reliance and ultimate aircraft production with home-made parts and designs never got off the ground. In reality, joint ventures in aircraft manufacturing had defeated the very purpose of their existence.92

AMERICAN FRUSTRATION

The Americans, too, had many bones of contention. To begin with, it was quite plain from the joint venture agreement establishing CNAC and subsequent events that they would supply aircraft, personnel and cash funds whereas the Chinese would only pledge their credit and moral support. While this seemed an unfair and somewhat high price for the Americans to pay, the promissory notes and bonds guaranteed by the Chinese were in fact not worth the papers they were printed on. Most importantly, the joint enterprise did not turn out to be as profitable, or as promising, as the foreign investors had envisaged. Insofar as CNAC was concerned, in 1933 it was on the verge of total collapse. At that point, because of the apparent bleak future of the airline, and the economic crisis in the U.S., the American partner was no longer willing to put more capital into the venture as they were expected to. Their anxiety to withdraw their involvement completely was only saved by Pan Am’s decision to acquire their interests in China. With the change in American ownership, the Sino-U.S. venture was finally able to yield its first profit in mid-1935. Although in the later years revenue continued to improve in general, war conditions, skyrocketing operating costs, fluctuating exchange rates and depreciation of Nationalist currency never ceased to plague the airline financially.93

American frustration did not stop short at financial setbacks. Unaware and unprepared at first, the foreign partners and the joint ventures soon found themselves entangled in the intricate web of Chinese politics. Specifically, the problem was two-fold. First of all, as a brand new mode of transport, CNAC immediately became a subject of jurisdictional dispute between the Ministries of Communications and Railroads, respectively, in China. Because the Minister of Railroads, Sun Fo (who, incidentally, was the son of Dr. Sun Yat-sen) initiated and concluded the original

92. The Communist Chinese are especially critical of the Nationalists in this regard. See Chiang, Ssu-shih nien ti hsin-hsiao, k'ung-chi ho ya-p’o. (Forty Years of Torture, Attack and Oppression), 3 HANG-K’UNG CHIH-SHE 23-25 (AVIATION KNOWLEDGE) (February 1960).

93. LEARY, DRAGON’S WINGS, supra note 73, at 205-12.
contract with Aviation Exploration, the Ministry of Communications took offence and retaliated by refusing landing permission to CNAC aircraft at all civilian airports. In the long run, the American investors had to make the "Six Percent Gold Loan" to Sun Fo’s office to enable him to construct airports for CNAC aircraft landing. Despite instructions from the State Council, the Minister of Communications declined to honor the contract and refused to make disbursements to the U.S. partner from the postal receipts. When disbursements were finally made by the Chinese, they were in the form of unsecured promissory notes. Putting aside the politics involved here, this will serve as a good illustration of the extent to which China had relied on heavy borrowing in its business ventures during the pre-1949 period.94

The second aspect of the problem may be attributable to the continuous struggle for political power in early twentieth century China. Although China was officially unified as a country in mid-1928, the Nationalists government in Nanking did not enjoy the full support of the factional and regional leaders. More than once, warlord rivalry prevented the extension of air services into areas outside de facto central control. In addition, because of the combat potentials of civil air transport, there had been repeated attempts by the Military to gain control of the airlines. All this only made the task of running an airline in China more cumbersome than it already was.95

II. The Lost Years (1949–1972)

With the advent of the People’s Republic, U.S.-China political and economic relations came to a standstill for more than two decades. In the meantime, American capital investments in aviation quickly and totally disappeared from the Chinese scene. That, however, did not absolve the new government on the Mainland from alien involvement in the civil air transport sector. Although foreigners still played a decisive role in the next decade, the scenario was no longer one of nations scrambling for concessions, or spheres of influence. Of course, fortunate for the new regime, there was also no foreign aggression. As a sharp contrast to preceding decades, however, only one world power

94. Young, Helping Hand, supra note 73, at 45–48.
95. For an illuminating account on provincial warlordism during this period, see Barnett, China on the Eve of Communist Takeover 57–80 (1963); Leary, Dragon’s Wings, supra note 73, at 113, 179.
became politically and economically involved with China. It was from this source alone that the Chinese aviation industry derived its sustenance and strength. This early one-sided foreign investment and procurement strategy of the PRC was to create far-reaching consequences in its subsequent policy of aviation technology import.

**THE SOVIET MISMATCH**

On the eve of the Mainland takeover, the PRC inherited a crisis-striken civil air transport industry. The aftermath of the war of resistance against the Japanese, and the ensuing civil war had left few aircraft or parts which might be of practical value to the new government. While most of the airfields and navigational aids had been destroyed or severely damaged, there was a general lack of aviation fuel, trained pilots and technicians. To aggravate this problem, the Communist Chinese were unsuccessful in a legal battle to regain ownership of over seventy airplanes belonging to CNAC and CATC in Hong Kong. As air transportation was extremely vital to national economic and defense interest at this time, the new leadership was therefore forced to confront a serious problem not dissimilar to one which their predecessor had to face in 1929. Basically it was a dilemma of choice. Rather than just a question of whether or not to invite foreign capital and technology into China in such times of need, it was an ideological choice of whether or not condemned history should be allowed to repeat itself.

Since the PRC had then adopted a bipolar view of world politics, its political and economic options were limited. Apart from the ideological affinity, the Soviet Union was in fact the one and only nation willing and eager to lend the new leadership in China a helping hand. As to be expected, the latter was hardly in a position to refuse the offer. Subsequent to the signing of the

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96. The case ultimately went on final appeal to the Privy Council (Highest appeal court for the British colony) in 1952, and was decided against PRC interest. *See Civil Air Transport Incorporated v. Central Air Transport, Corp. 2 All E.R. 733 (1952).* This prompted a rare, but interesting scholarly legal rebuttal from the PRC. *Li, Legal Questions Arising from Hong Kong's Detention of Airplanes Belonging to China National Aviation Corporation and the Central Air Transport, 2 Hsin Chien-she 2–6 (NEW CONSTRUCTION). (No. 10).*

97. For an analysis of the economic and political problems the PRC faced at that time, *see Barnett, Communist China: The Early Years, 1949–55 (1964); Fitzgerald, The Chinese View of Their Place in the World 38–57 (1964).*
Sino-Soviet Treaty of Friendship, Alliance and Military Assistance (1950), the two nations immediately came to terms on various form of Soviet assistance. Among them was a ten year agreement which provided for the establishment of a jointly-owned and operated airline in China. In reality, the Sino-Soviet airline became the first and last of any form of joint venture in civil aviation in which the new Chinese government ever participated. For this significant reason, and especially for the purpose of evaluating future prospects in this area, it is necessary to take a closer look at the agreement which gave rise to this airline.

According to a Joint Communique issued by the two countries, Sovetsko-Kitaysko Aksionernoe Obschestvo Grazhdanskoj Aviatsii (SKOGA) — the Sino-Soviet Joint Stock Airline — was organized to “... help develop civil aviation in China, and to strengthen Chinese Russian economic cooperation ...” Because of the partners’ mutual reverence for national sovereignty, it was decided that the airline should comply with “laws pertaining to business enterprise and revenue income of the Chinese government.” Based on the principle of equality, the parties were to have equal shares, and even sharing of company profits and expenditures. As part of their investment, the Chinese undertook to provide SKOGA with the land, factories, housing and building materials for any other constructions. The Russian invested capital comprised of various mechanical installations, as well as industrial, surveying and aeronautical equipment, including aircraft. Not unlike joint airline ventures in the Republican period, the agreement also provided for the training of Chinese technical and administrative personnel. Pursuant to Article 14 of the agreement, the airline could open schools and courses or send Chinese citizens to be trained in the Soviet Union.

99. Joint ventures were established on March 21, 1950 for petroleum production, rare metals and civil aviation. As with others, the contents of the joint airline SKOGA was never disclosed publicly. Present analysis has been based on information from the Chinese news media and Soviet Press Translations. It is clear that most of the joint ventures shared very similar features.
While management authority was vested in the Administrative Committee, the two partners had agreed that the Chinese representative would appoint the President and Assistant General Manager of SKOGA for the initial term and to serve on a two year rotational basis. This meant that although the Russians would initially fill the positions of Vice-President and General Manager, at the end of the first two year term, they would replace the Chinese in their positions and vice-versa. Clearly, this represented an important deviation from previously established practices.

During the first eighteen months of its operation, SKOGA did not receive much attention from the Chinese press. But by the end of that time, an administrative office and nineteen field offices had been set up. In November 1952, it was reported that the Sino-Soviet airline had been successfully serving Chita, Irkutsk and Alma Ata from Peking. Samples of China's products, precision instrument and machinery ordered from abroad by the Chinese were being sent via SKOGA. Hailed as an "advanced Socialist civil aviation transport enterprise" with an unblemished flight safety record, the Sino-Soviet airline had, during its four years of existence, completed "... 13,500,000 kilometer-tons, carried several tens of thousands passengers over 1,600 tons of mail, and 4,700 tons of freight."\(^{101}\) By 1954, there was little doubt that SKOGA had assumed a vital role in the economic development of the PRC.

As the economy was slowly rehabilitated and the Chinese had become better trained and equipped to direct the activities of the various joint business enterprises, the PRC and Soviet Union decided that the time was ripe for reassessment and change. Toward the end of 1954, the Soviets finally agreed that they would transfer their shares in four joint stock companies back to the Chinese.\(^{102}\) Since SKOGA was among four companies selected to undergo the ownership change, a six member "Transfer Work Committee" was formed to organize and facilitate the winding up process and transfer of assets. Before the year expired, the Russian share of the assets and securities in SKOGA had been turned over, and the Chinese were thus able to integrate all

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102. NCNA, (Peking), October 12, 1954.
existing routes and services into one state-owned airline called CAAC. Far more important, the complete transfer of Soviet interests in SKOGA marked the end of foreign capital and control in Chinese civil aviation.

AN AFFAIR TO REMEMBER

Looking back, in one respect, China's experience with SKOGA was relatively more beneficial than that with CNAC twenty years ago. Unlike CNAC, the foreign partner in this case could not be criticized for their part in the training of local personnel. Although at the outset Soviet comrades outnumbered their Chinese counterpart in several technical departments, at the fourth anniversary of the airline the latter had become three times the number of the former. By then Soviet experts had not only put together twenty-four special training courses for the Chinese staff of SKOGA, they had also furnished it with Li-2, Il-2 and Il-14 transports, maintenance equipment and spare parts. During this period, many volumes of Soviet civil aviation rules and regulations, as well as related documents, were translated into the Chinese language.103

On the other hand, however, from the time SKOGA went into operation, and because of the Korean War and the resulting embargo on trade, the PRC had become progressively dependent on Russian aviation know-how, aircraft, equipment and related supplies. Chinese pilots, crew and ground personnel also faithfully and exclusively emulated the Soviet model. At first when relations with the Soviet Union were normal and cordial, the Chinese Communists did not feel the anomaly of their "lean-to-one-side" policy. But later, as bilateral relations began to rupture, they slowly came to grip with the vestiges of the "Sovietization" process. The telling moment finally came in 1960. In the summer of that year the Russians withdrew all their technical advisers and assistance from the PRC.104 For the future of civil air transport in China, that event touched off some very serious problems.

First of all, since the pilots and ground staff in SKOGA (and later CAAC) had been Soviet-trained, and had been taught only to fly Russian-made aircraft, most of them were unable to operate U.S., British or French manufactured aircraft until very recently. For these people, the airline later had to consider the necessity of "re-education." As a matter of fact, the situation is really not dissimilar with the need for pilot "re-training" in the case of a merger of two or more airlines using different types of aircraft and equipment. A case in point is the merger of Bonanza, Air West and Sundance Airlines to form Hughes Air West in the United States. There, the new company suffered an initial loss as the management failed to plan for such a contingency. While the exact amount of time and cost for familiarizing a Chinese pilot with, for instance, a Boeing 707 is not readily known, a general idea may be derived from the fact that it normally takes a minimum of one month and $50,000 to properly teach a Boeing 707 pilot to fly a Boeing 747. It necessarily follows that the time and cost will be much more in the case of a Chinese pilot who has to switch from a Russian Ilyushin to an American Boeing.

In the second place, it should be emphasized that Soviet aid during this period was not in any way gratuitous. It is estimated that by the end of 1957, China was indebted to the Soviet Union in the amount of JMP $5,294 million for the aid, assistance and loans the latter had provided. The purchase price for Soviet interests in SKOGA was apparently included in this. Assuming that the above loan was being liquidated by the Chinese at a rate of JMP $500 million per year, it would have taken at least ten years to pay off the principal alone. Since the Russians had always insisted on punctual repayments, the financial burden on the Chinese was obviously immense. In turn, that adversely affected China's aircraft production and acquisition capabilities.

In reality, of course, by far the brunt was felt by the Chinese airline and aircraft industry as a whole. By nature, the industry is a particularly vulnerable one. It depends on viable modern technology, capable personnel, reliable aircraft fleet, proper maintenance and adequate fuel and parts supply. Without them,

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105. Notes on Airline Industry (Reading materials, Stanford Graduate School of Business, 1975.)
the productivity and utility of the industry will be seriously limited. That was the greatest difficulty which Chinese aviation on the Mainland encountered with the sudden Russian pull-out, for not only did the Soviets leave with their blueprints of aircraft models and their instructions manual, they took away the assurance of constant backup in expert advice and parts supply. What they left behind was a fleet of almost entirely Soviet-made aircraft with little hope of upgrade and high chances of obsolescence.108 Worst of all, without the Russians, the PRC fell behind in its aeronautical technology. Indeed, the Chinese themselves concede, and American experts concur, that the PRC is now at least twenty years behind the contemporary western world in the aerospace industry.109

WALKING ON TWO LEGS

In retrospect, the many setbacks notwithstanding, at least one good did come out of the Sino-Soviet split. If anything, it helped revitalize the ingrained Chinese pride, and spurred on the People's Republic's desire to be self-sufficient. As a result, subsequent to the Russian withdrawal "self-reliance" became a national economic priority in the PRC. As a concept, however, this is not really new to China. The Chinese have in fact advocated "self-reliance" in civil aviation since the Nationalists' days in Nanking. Indeed, in 1927 when Sun Fo entered into the first air mail contract with the Americans, many Chinese had protested vigorously and unsuccessfully, in the firm belief that China could, and should have gone it alone.110 But then to the Chinese government at that time, faced with the problems of unification and national reconstruction, the advantages of instant foreign capital, equipment, know-how and entrepreneurship seemingly, and probably rightfully, outweighed all other concern. Thus, although "self-reliance" may have been preached, it was certainly not practiced in the period before 1949.

109. Id., Heymann.
110. For a selection of petitions against American involvement assembled by the then Chinese Minister of Communications, see 47 Chiao-t'ung kung-pao 34-40 (Official Reports on Communications), (Ministry of Communications, China, 1929).
When the Communists came to power in China, they quite naturally viewed their predecessor's attitude with distaste. In their opinion, the Nationalists had ruined the country with their corruption, their collusion with wicked foreigners and their totally misguided plans and efforts (or rather the lack of them) in national political, social and economic planning. Like other sectors of the foreign dominated pre-1949 Chinese economy, civil aviation was perceived by the new leaders as a painful part of China's developmental experience.\textsuperscript{111} Being so, it prompted a sense of humiliation which Chinese on the Mainland now would so spontaneously identify as an essential product of colonialism and Imperialist exploitation. In the light of such unsavory early encounters with the West, China's new leadership had developed a yearning for the preservation of self-respect, equality and national sovereignty in its dealings with foreign nations from the very start.\textsuperscript{112} Hence, later on, when they had to turn to the Soviet Union for various form of assistance, the PRC leaders did so uncomfortably. Nevertheless, they were able to reconcile it then in terms of genuine Soviet concern and equality, as well as mutual respect.\textsuperscript{113} As the Chinese fell out with the Soviets, what was once considered "brotherly love" unfortunately turned into outright "Social Imperialism." Obviously, foreign help was justified no longer. That Sino-Soviet enstrangement and abrupt Soviet withdrawal of assistance came at a time when the nation was facing an oncoming depression only further aggravated the feeling of betrayal on the part of the Chinese. In the final analysis, therefore, the Soviet experience turned out to be a second baptism of fire for China. Together with the stigma of foreign domination in pre-1949 China, it prodded the Chinese on the Mainland onto adopting a firm and unprecedented commitment toward "self-reliance." It was then that "walking on two legs" became an over-riding priority in Chinese history.

PROCUREMENT THROUGH PURCHASE

Meanwhile, in the years that follow, in response to the Russian departure, the Chinese tried a new strategy in replenish-

\textsuperscript{111} Supra notes 15, 24. See also Shih, Lieh Ch'iang tsai hua ti hang-k'ung ching-cheng, (Various Powers Vying for Civil Aviation in China), 1 SHEN PAO CHOU-K'AN 301-02 (SHEN PAO WEEKLY).

\textsuperscript{112} Cf. China's condemnation of unequal treaty, and its later preference for the Five Principles of Peaceful Co-existence.

\textsuperscript{113} Wci, supra note 98; chung-su yu-hao kuan-hsi hsueh-hsi tsu-liao (Learning Materials for Sino-Soviet Friendly Relations), (Peking: Lien-ho she, 1950).
To begin with, the People’s Republic resorted to “purchase” rather than the traditional modes of foreign assistance or investment as a means of technology procurement and transfer. Initially this was not easy; the available market was saturated with sales restrictions against the PRC. In spite of the limited procurement opportunities abroad, however, Peking managed to import civil aircraft from several sources. In the early sixties, having deliberated on prospects of direct purchases from France and the United Kingdom, the PRC bought from the latter a total of ten Vickers Viscount 843s. Through Pakistan, the Chinese afterwards acquired four used British manufactured Trident 1 jets. This was followed by more orders for the Tridents from the U.K., and the purchase of ten Boeing 707s from the United States in the early seventies. At about the same time, the PRC entered into a preliminary agreement for the purchase of two Anglo-French Concorde SSTs. Finally, toward the end of 1975, Peking signed a contract worth at least $190 million with Rolls Royce of U.K. which provided for sale of a certain number of Spey aircraft engines and the manufacture of such engines in China under license for a period of five years. Under this agreement, the engines to be built will be suitable for civil and military application, and Rolls Royce will explain all technical data, and assist the Chinese in engineering planning, factory layout, tooling and personnel training. China would receive the firsts of the agreed upon minimum of fifty Spey engines in two years. With ultimate onstream production, the Chinese should be building their own Speys before the end of the decade.

114. For a most recent compilation of CAAC’s airplane acquisition data, see Szuprowicz, supra note 71, at 38-42.

115. The Boeing contract was signed in September 1972. The Chinese were reportedly interested in the Boeings 18 months ago through talks and questions in European embassies. Boeing Company later pursued the sales lead, and was invited to China in April, 1972. After negotiations and a second visit, the agreement became finalized. Besides the sale of ten Boeing 707s, the U.S. company also promised to provide flight training in Seattle, and later in a Shanghai facility. The purchase price was widely reported to be close to $150 million.

116. The contract between Rolls Royce and China National Technical Import Corporation (Tech-import) was signed in December 1975. By the following month, a Rolls Royce team was already seen in China helping the Chinese with site survey and engineering layout. Under the agreement, the Chinese were not only allowed to make future improvements on the Spey engines, but they could also, at their discretion, use them for civil or military purposes. Sale of these locally built Spey
Given this complex aircraft and aero-engines shopping list of the Chinese, certain basic patterns become apparent. We can see that the PRC had been acquiring such aeronautical technology and equipment as it deems necessary very selectively — carefully avoiding purchases from one source alone. But there were other motivating factors besides prudence. Clearly pragmatism and diplomacy played an important role in the Chinese approach to procurement from the West. For example, in order to serve her political and economic interests in Africa and Europe, China decided to enlarge CAAC's international fleet. In the process of doing so, the Chinese deliberately acquired more than one model of long range aircraft. By purposely selecting the Il-62 jet transports from the Soviet Union, China kept its options open with the Russians. But more important, in buying the other model — the Boeing — from the Americans, China not only provided a stimulus to Sino-U.S. political and commercial rapprochement, it also succeeded in promoting a competitive environment in the world civil aircraft market which has proven extremely favorable to the Chinese. The latter situation is especially significant for China. In creating and putting itself in what may be called a “buyer’s market”, it has been able to benefit politically as well as economically by simply manipulating and playing one competitor against another. To a similar extent, this has happened to nations negotiating with the PRC for agreements on air traffic rights. In that case the PRC has been placed in a strong bargaining position owing to the enthusiasm of the many foreign airlines in flying to the Chinese Mainland. That engines to a third country is subject, however, to Rolls Royce’s approval. Perhaps as a gesture of goodwill, the employees and the company of Rolls Royce were guaranteed the right to British legal counsel in case of violation of Chinese law. See China Deal to Build Powerful Rolls Jets, NYT, December 15, 1975; 3 U.S. CHINA BUS. REV. 51-52 (Jan-Feb. 1976); 3 U.S. CHINA BUS. REV. 40 (July-August 1976); AVIATION DAILY, December 29, 1976, at 19; 18 FEI-CHING YUEH-PAO 100 (COMMUNIST BANDITS AFFAIRS MONTHLY).

117. Sale of two Il-62Es and spare parts in 1971 was reported by Moscow Broadcast on June 18, 1972. In the same year, the PRC bought another three Il-62Es, bringing the total to five. This was later confirmed by Heymann, supra note 108, at 164. All the orders were placed subsequent to the revival of Sino-Soviet trade after a three year suspension.

118. For example, see British & U.S. Lock Horns Over China Jet Deals, South China Morning Post (Hong Kong) March 30, 1973.
helps to explain, in part, why Japan gave up its profitable Taiwan air route at the PRC's request during their negotiations in 1974.\textsuperscript{119}

\textbf{MAKING FOREIGN THINGS SERVE CHINA}

Now, if we would only pause for a moment and relate the foregoing to China's "self-reliance" policy. Are they not inconsistent with each other in theory and in practice? If not, how might one explain current PRC policy in the acquisition of aviation technology?

The fact is, although maximum utilization of indigenous human and natural resources have become the key in the People's Republic's struggle for autarky, practical needs have inevitably developed for which import of foreign goods and technology was sometimes required. Not only in civil aviation, but in other industries, the lack of know-how, or the inability to overcome technological bottlenecks, have often motivated the Chinese to procure from abroad. For instance, in order to explore its off-shore oil potentials, the PRC has purchased oil drilling and engineering equipment from the U.S. and Japan. All that, however, does not imply any change in the basic policy of "walking on two legs." It only means that, instead of walking "blindly" on two legs, the Chinese have adopted a pragmatic, highly selective and well-planned strategy of development. Moreover, it proves that in pursuit of progress, the Chinese leaders have reasoned and accepted foreign technology as a means to an end in self-sufficiency. To them, the key or the "correct line", then, is to "make foreign things serve China."\textsuperscript{120} Accordingly, the Chinese aviation industry has been taught to "first use, secondly criticize, and thirdly transform" foreign technology through self-reliance "to speed up the pace of socialist construction."\textsuperscript{121}

From another perspective, the theoretical inconsistency can also be explained in terms of Mao's dialectic approach. In other

\textsuperscript{119} In the long run, however, it was restored. Japan now operates to Taiwan through Japan Asia Airways, a private company.

\textsuperscript{120} The Peking Review of January 1, 1977 carried one of Chairman Mao's speeches in 1956 entitled \textit{On the Ten Major Relationships}. In it, Mao had stressed that foreign things "should be learnt well in accordance with our own principles so that our work can be improved ..." He, however, deplored indiscriminate rejection or imitation of foreign technology. The importance given to this speech by the present Chinese leadership appears to indicate a more pragmatic approach, and a general endorsement of the policy of "making foreign things serve China."

words, self-reliance and import of foreign technology are apparent but reconcilable differences reinforcing and enhancing each other. Thus, if correctly handled, they can be productive to China's nation-building efforts as a whole.\textsuperscript{122}

Considering the present technological gap in civil air transport, the condition of CAAC's fleet, the adverse effects and likelihood of recurring political struggle on the mainland, there is every reason to expect that the People's Republic will continue to imbue western aeronautical technology in the times ahead. If it does, in view of Chinese pride and prejudices, the PRC will continue to be critical of the notion that "foreign equipment is almighty," or that "without foreign equipment no aviation product can be manufactured." Although China will accommodate and utilize techniques from abroad, based on historical influence, it will always be skeptical about the "inviolability" of foreign rules, and "blind faith in foreign theories, data and design."\textsuperscript{123} It is therefore essential that foreigners fully grasp this Chinese sensitivity before approaching the PRC market.

III. \textit{Sino-U.S. Prospects and Perspectives}

As the leading civil aircraft supplier in the free world, the United States will be a procurement attraction, among many, for the PRC. The possibilities are particularly alluring for the U.S. considering that the Chinese have openly expressed dissatisfaction with Russia's Ilyushin Il-62.\textsuperscript{124} Also the PRC's purchase of aircraft and related accessories accounted for $60 million, or 8.5\% of the total volume of Sino-American trade in 1973.\textsuperscript{125} From the U.S. point of view, since its own airlines are normally unable to afford any substantial aircraft purchases, foreign markets have, for many years, been a chief source of revenue for its aerospace industry and, in turn, its balance of

\textsuperscript{122} On the basic concept, see MAO, ON THE CORRECT HANDLING OF CONTRADICTIONS AMONG THE PEOPLE, (Peking, Foreign Languages Press, 1957).

\textsuperscript{123} Supra note 53. See also Romensky, Study \& Criticism Scores Those Who Worship Things Foreign, FBIS, People's Republic of China, August 29, 1974.


In the face of stiff foreign competition, a successful China market for the U.S. would extend production runs, lower manufacturing costs, support domestic employment and provide the necessary financial strength to enable the U.S. aircraft builders to maintain their technical as well as sales supremacy in world market. Besides, certain components of the aircraft industry now feel that they could capitalize on the equipment standardization logic, market familiarity and the experience of their previous, and particularly, their most recent dealings with the Chinese. At the same time, many American airlines have expressed keen interests in developing the PRC market. Meanwhile, the administration may be contemplating sale of sophisticated aviation technology to the PRC in order that it may be strengthened to act as a countervailing force to the Soviet Union. Whatever the U.S. motive, the question is simply this: in time, will the People's Republic look again to the U.S. to satisfy its growing civil aviation needs? If so, what will be its specific objectives and acquisition strategy? Assuming that direct purchases will be made, what is the likelihood of traditional transfer modes such as licensing and joint venture? Will the Chinese on the Mainland allow the Americans to continue from where they left off in 1949? In response to this, a number of very tentative speculations may be put forward.

**AIRCRAFT TECHNOLOGY**

In the area of aircraft technology, the PRC will be expected to make direct airplane purchases from the U.S. in the foreseeable future.

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126. Foreign Purchases of U.S. civil aviation products accounted for about 35% of the industry's sales from 1958–69. Between 1965 and 1969, the aircraft industry contributed 58.9% of total favorable balance of trade, with civil aircraft making up 34.6%. Civil Aviation Research and Development Policy Study 5–29–5–35 (Washington, DC: DOT & NASA, 1971); The Next Commercial Jet if U.S. Airlines cannot Afford to Buy It . . . , Bus. Week, April 12, 1976, at 62–67. This may have been altered recently by United Airlines' $1.6 billion order from Boeing Co. See San Francisco Chronicle, July 15, 1978.

127. Pan Am, United, Northwest, TWA and Capital International have all petitioned the CAB for a hearing on the reopening of the China route. Supra note 8.

128. In 1973, China bought 15 Nomad STOL from Australia. Lately, the Chinese have expressed great interest in the British Harrier. Note, the U.S. has been actively involved in developing the prototype YC–14 STOL which is an advanced medium/short takeoff and landing transportation aircraft. It is roughly the size of a Boeing 727, has twin engines and improved lift capacity. The Chinese are interested in aircraft of this nature for largely military logistic reasons. Since the VTOL/STOL do not require the usual lengthy runway, they are easier to conceal from enemy, and particularly, Soviet reconnaissance.
future. Should any purchases be made, it is doubtful that they will be of the size and model of the Boeing sale in 1972. Instead of concentrating on long-range aircraft, Peking will probably begin looking at wide-bodied and fuel-economy medium range models such as the Boeing 767 which are apparently suitable for domestic Chinese use. At the same time, the PRC may also look for aircraft used for geological surveys, aerial photography and crop dusting in the U.S. general aviation market. 129

Since continuous direct aircraft purchases would create political and economic objections, the People's Republic will be constrained to consider other technology transfer options such as licensing agreements in aero-engines or aircraft production in the hope of accomplishing independent indigenous output in the long run. Unless extremely drastic changes take place in China, however, the possibility of direct U.S. participation in aviation joint ventures will be limited. The reasons for the preclusion of joint ventures are both economic and political.

To the PRC, the notion of a joint venture involving foreign and private equity ownership and management participation is contradictory to Socialist economic theory. Unlike Yugoslavia, Hungary, Romania and the U.S.S.R., the PRC has not yet adopted an overall conciliatory approach to foreign investments in its economy. 130 In fact, on many recent occasions, the Chinese have spoken very strongly against "running joint enterprise with foreign countries," "joint management," and in particular, exploiting "her natural resources on a joint venture basis with any foreign country. . . ." 131 Along this line, a joint venture proposition from the U.S. would be construed and condemned as

129. For example, the PRC recently ordered four Gates Lear jets. Three of them are intended to be used as ambulances, and the last for photomapping. AWST, August 7, 1978.

130. Cf. McMillan, Changing Perspectives on East West Commerce (1974); Lamers, Joint Ventures Between Yugoslay and Foreign Enterprises (1976). The PRC, however, has formed a joint-stock steamship company with Albania. Whether the recent withdrawal of Chinese aid from Albania has affected it is unclear.

an American attempt to bring China back into the pre-1949 era of foreign economic domination. At the same time, it must be stressed that even though the PRC had purchased American aircraft in the past, it did not mean that the Chinese had faith in their products or intentions any more than they had on their British or the Russians competitors. For example, in the sale of the Boeings, the PRC had insisted that the U.S. furnish them a 100% spare parts and engines stockpile. The 125 page contract with Boeing included provisions for pilot and ground training, and for the maintenance of a back-up technical crew in China well into the early phases of scheduled operations. While the Americans found the contract negotiations to be lengthy, technical and often "rigorous and difficult," the Chinese criticized their counterparts for being too "legalistic and overly protective" in their proposed draft agreement.132 Regardless of what actually transpired during the Boeing negotiations, the inferences are clear. When political and business relationship between the two countries had been virtually nonexistent for over two decades, initial economic or technical contact and cooperation can only be made in a gradual and not grand fashion. Impatience would only create unwanted risk detrimental to mutual goodwill and interests. Under these circumstances, a simple licensing agreement involving technology transfer and minimum risk would seem more appropriate than a joint venture which generally demands a more permanent and institutionalized relationship entailing capital outlay, more responsibilities and business hazards.133

While I am not optimistic about direct U.S. participation in joint ventures in the People's Republic, I am not altogether ruling out such a possibility. Indeed, two recent Chinese decisions have been particularly thought-provoking in that respect, the foremost being the PRC's revived interest in overseas Chinese.

As far back as the 1950s, "Hua Ch'iaos" have contributed substantially to the Communist Chinese economy through foreign

133. Cf. The U.S. and the Soviet Union are now engaged in co-production and co-marketing activities. One example can be found in Soviet-Bendix Breaks Ground in Trade with Russia, Bus. Week, January 11, 1977. By virtue of this agreement, Bendix will make spark plugs in Russia, and 75% of production will be sold in Russia. The remainder will be sold through Bendix's own international marketing network. Bendix reportedly retains control to a degree rare for foreigners, although the Soviets will manage the plant themselves.
exchange earnings and remittances. Some have even returned to the Chinese Mainland to take part in the socialist construction. Among them were scientists of various disciplines who either gave up their foreign citizenship or residence to come home. This, for example, included eminent scientists like Dr. Ch’ien Hsüeh-shen, the missile and jet propulsion specialist of Massachusetts (as well as California) Institutes of Technology fame. Then there were those who brought capital with them to invest in specially established investment corporations. By and large, however, the enthusiasm of the returnees and the government itself fluctuated with time, and with domestic as well as international political vicissitudes. Nevertheless, early this year, the People’s Republic once again began to appeal to overseas Chinese and especially scientists to come to China. From the U.S. alone, as a start, some 400 scientists are expected to answer the call. Reportedly, Peking’s leaders are contemplating allowing affluent overseas Chinese to invest capital and know-how in domestic export-oriented industries. This brings us to the second point; that is, in the meantime, the PRC has instructed its overseas banks to adopt “capitalist methods” such as foreign exchange, stocks and realty speculation to bring in a better financial return.

Taken together, these two decisions suggest that, in order to meet the goals set for a second “Leap Forward,” the People’s Republic has resolved to be realistic and pragmatic about non-socialist ways and means. The rationalization is that, like “making foreign things serve China,” national construction can

134. See Wu, Dollars Dependents and Dogma (1967).
139. Now, with Vice-Premier Teng Hsiao-ping’s return to power, China’s pragmatic economic policy can be expected to continue.
still retain its socialist character as the Chinese creatively use or experiment with capitalist methods. The key justification, however, is that outside capital and technology is introduced here through foreigners who are ethnically and emotionally Chinese. In the case of the overseas Chinese bank, again, it is the Chinese or overseas Chinese, and not the foreigners, who are making the investment decisions and the profits. That being the case, joint ventures are less objectionable as control and initiative do not fall into the hands of the “non-Chinese.” Conceptually speaking, China will still be “walking on two legs,” because even though one of them is technically a transplant, it is nonetheless biologically compatible, and thus acceptable to the body as a whole. Whether or not foreign investment “in disguise” will work in the long run, only time can tell, but at this very moment, there are quite a few American-Chinese who are ready and willing to offer the People’s Republic their capital and their western-taught know-how which makes the option one worth considering.

If both countries should, however, choose licensing as the medium of technology release, provisions must be made to protect U.S. technological advantage. Ideally, of course, only such technology based on “mature” products line and available production technique should be transferred. In the process, the U.S. must keep in mind that the detection and prosecution of patent or know-how rights infringements could be difficult in the PRC. It will remain a problem until the People’s Republic becomes a member of the International Convention for the Protection of Industrial Property.140

**Airline and Tourism**

Much of the same regarding aeronautical technology may be said of the airline industry in the Sino-U.S. setting. It is safe to assume that a joint stock company or venture similar in structure and function to CNAC or SKOGA will not be feasible on the Chinese Mainland on account of past PRC experiences, and the complete control the state now asserts over civil air transport.141 This, however, does not preclude other forms of cooperative


141. Reporting directly to the State Council, the General Administration of Civil Aviation is the state organ in control. It serves the functions of the CAB, FAA as in the U.S., and performs special and commercial aviation tasks.
arrangements. In this connection, the key factor is People's China's recently demonstrated interest in developing its tourist industry and in extending its air services abroad.142

At present the Chinese flag carrier CAAC is regularly serving a total of fourteen nations in Asia, Africa and Europe. Even so, by conventional standards, its operational methods have been described as unsophisticated, and its customer and cabin services as deplorable. As the People's Republic assumes an even more active part in international and air commerce, it may eventually become concerned about the below-par rating and may desire to improve.143 After all, even though CAAC is state-owned, there is no reason why it should not be self-supporting and efficient, or any less concerned with costs and revenues. If anything, like Russia's Aeroflot, it ought to enter foreign markets with the same marketing consciousness as its competitors. In this regard, major American airlines could become very useful. Under a cooperative agreement, an American carrier such as Northwest, TWA or Pan Am could provide CAAC with the necessary assistance in market and operational research, pricing, efficient scheduling, data processing of reservations and departure control, management training and customer servicing in return for its promise to purchase the carrier's used aircraft or other equipment, or for traffic rights into the PRC. Agreements of this nature are now commonplace in the Asia and Pacific region.144

Elsewhere, the growing number of people visiting the Chinese Mainland has prompted the China Travel Service (CTS) to carefully review its own needs and capabilities. Thus, recently CTS in Hong Kong has seen fit to activate the old CNAC office there to handle some of CAAC's reservations and ticketing activities. More importantly, it has expressed the desire to install modern computer and communications facilities to manage CAAC and hotel bookings as well as other travel arrangements in the PRC.145 Obviously there will be a similar need for CTS offices in the People's Republic and abroad. This would mean sales

143. For example, see The Dividends of Rediscovery, Time, November 20, 1972, at 34–35. See also Ward, supra note 124.
144. For a brief account, see ICAO BULLETIN, May 1976, at 45–47, 57; November 1976, at 20–23. Lately this has also become commonplace in Africa and the Middle East. ICAO BULLETIN, May 1978, 55–57.
145. Information based on computer sales sources in Hong Kong.
opportunities for the American computer industry. At the same time, it could open up a possible avenue of contact and cooperation between the American and the Chinese tourist agencies.\(^\text{146}\)

With its recent decision to promote tourism as an industry, the PRC has also stepped up its efforts to renovate and to expand its hotel accommodation facilities in over thirty designated locations.\(^\text{147}\) Lately hotel personnel were even sent to Hong Kong for practical service and management training. In this light, a successful American franchise enabling the construction of Duna Intercontinental Hotel in Budapest in 1967 raises another interesting possibility in the PRC. It is conceivable that an agreement of a similar nature could be reached to make way for a wholly-owned subsidiary of a U.S. airline engaged in the hotel or catering business (e.g., Pan Am and its Intercontinental chain subsidiary known as IHC) to assist the Chinese in constructing, designing and training the staff of a new first class hotel at a chosen location on the Mainland. The Chinese will be permitted to use the goodwill and name of the hotel chain. For their part, the Americans will be paid a franchise fee, or a combination of fee and other concessions.\(^\text{148}\) In this manner, it bears a close resemblance to the Rolls Royce agreement. The difference is only that, in the present case, success depends on whether, given the often fluctuating political climate, the PRC will continue to promote and expand tourism trade in the ensuing decades.

One other aspect of civil air transport development in China should also be of interest to the United States. In February 1978, CAAC held a civil aviation meeting which was attended by over three hundred Chinese representatives. During the meeting, an emphasis was made on “learning from Tachai” and “Taching”; and a decision was announced to modernize aviation in the next

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146. Pan Am has set up a subsidiary travel agency in Peking to handle its tour groups in China.

147. Supra note 74.

148. Pisar, Coexistence and Commerce 353 (1970). Together with Tower International, another U.S. company, Intercontinental Hotels Corporation (IHC), a Pan Am subsidiary, entered into an agreement for the construction and operation of luxury hotels in Hungary, Rumania and Czechoslovakia. Later in 1974, IHC also signed an agreement with the Soviet government to build three hotels in the U.S.S.R., respectively located in Moscow (1500 beds), Leningrad (2,000 beds) and Kiev (800 beds). It was agreed that Skanska Cementgjuteriet, a Swedish company, would do the construction, and together with the IHC, would also be responsible for arranging Western finance. AWST, June 10, 1974, at 26.
five years "to keep pace with the growth in socialist construction, foreign relation and tourism." Of particular concern to CAAC was the construction of better and up-to-date airfields and terminals to cope with the country's growing air traffic activities. Although formerly only airports in Canton, Shanghai and Peking were capable of handling international jet flights, efforts are now being made to construct or upgrade airfields and terminals in key cities such as Tientsin, Hofei, Harbin, Hangchow and Urumchi. The new or improved runways average from 3,200 to 3,800 meters, and are presently being equipped with precision landing systems. In this connection, American avionics, and aviation consulting firms, and even airlines can assist in overall master and regional airport as well as systems planning. At a future date, American expertise may even be helpful to the Chinese in environmental analysis, and in the abatement of noise or air pollution in the airport vicinity. In the mean time, U.S. engineering companies will be especially interested in providing Chinese aerodromes with maintenance and overhaul facilities, and the necessary on-location personnel training. In all these situations, a management or service contract with CAAC might be preferred since it would entail a continuing relationship which is normally conducive both to mutual understanding and actual problem-solving. In essence, it is similar to licensing to the extent that it provides an organizational form without involving U.S. capital investment and the risks attendant.

One final observation must be made in the U.S.-China context. Granted that opportunities do exist in the aircraft and airline industry in the PRC, the role of the U.S. will not be an easy one. On the one hand, the administration may feel that immediate extension of diplomatic recognition and the MFN treatment to the PRC is a step in the right direction. On the other hand, however, Washington may also wish to maintain present U.S. economic and trade relations with the ROC. If that be the case, then the U.S. may have to adopt an "even-handed" policy toward Taiwan and Peking. Consequently, should the administration decide to license or sell advanced civil aviation technology to the People's

149. NCNA (Peking), February 23, 1978.
150. China New Service (Peking), September 1, 1977. Obviously this opens up a market for the U.S. in navigational aids and equipment.
151. In 1974, CAAC entered into a $800,000 overhaul and servicing contract for its Vickers Viscounts, with Hong Kong Aircraft Engineering Corporation (HAECO).
Republic, it may have to make an equivalent concession or sale to the Republic of China. While this seems logical enough, it will not be easy to accomplish. For one thing, considerable legislative action will be necessary, and the whole process could be time-consuming.\textsuperscript{152}

Even when prospects in the PRC materialize into facts, relationships with the Chinese are likely to be strained initially, and somewhere down the time line. Many of the problems such as political instability and serious mutual misunderstanding which had troubled CNAC and other joint aviation ventures in the past are likely to recur in one form or another. Ideological differences which had precipitated the Russo-Chinese split earlier on are even more likely to surface in the U.S.-PRC context and disrupt bilateral economic and business relations. Moreover, in contrast to the Russians in the early fifties, the Americans do not have the advantages of a "lean-to-one-side policy" at this time. Instead, they will have to compete constantly with their counterparts from the United Kingdom, France, Australia, Canada and Japan in order to stay in the China market. On top of that, depending on the circumstances, U.S. cooperative arrangements with the PRC, notably business joint ventures, could well have antitrust consequences.\textsuperscript{153} The problems are thus many and varied. For better or for worse, therefore, the U.S. must be at least psychologically prepared lest it relive the frustration of its trade experience with Russia in the past six years.\textsuperscript{154}

\textbf{Conclusion}

In many ways, the PRC on the mainland today is no different from that which existed half a century ago. In those

\textsuperscript{152} As between U.S. and China, the issue of frozen assets in the respective countries has not been satisfactorily resolved. The possibilities of seizure of Chinese goods or purchases in the United States therefore remain open. With diplomatic recognition, this problem should be eliminated, but existing U.S. laws pertaining to Export-Import Bank financing, OPIC, MFN treatment and arms transfer in general must be appropriately amended to permit an "even-handed policy." This takes time and effort. For a study of some of these problems, see Li, De-RECOGNIZING TAIWAN, supra note 13.

\textsuperscript{153} For a treatment of the subject, see Fugate, FOREIGN COMMERCE AND THE ANTITRUSTS LAWS, (1973). In general, joint ventures which include marketing in their activities are probably most antitrust vulnerable.

\textsuperscript{154} For an interesting discussion on the decline of the U.S.-Soviet trade, see Businessmen's View — U.S.-Russia Trade is in Big Trouble. S.F. Chronicle, September 13, 1978.
days, the “Middle Kingdom” was egoistic, politically unstable, and scientifically backward. It was suspicious of foreigners, of their intents, and of what they can do to undermine its Confucian culturism. At the same time, though, it was not blind to the problems of stagnation, and the significance of modernization. Fifty years later, China is still in transition. Far from being settled, it now faces political and economic challenges at home reminiscent of those of the past. Beleaguered by recurring political struggles and natural calamities within, the China of today still finds it a difficult task to feed and care for its masses. Of course, the PRC continues to industrialize; but like its predecessor, it finds its own scientific knowledge and technical resources as yet inadequate to provide for its avowed goals. In a repeated performance, China has thus imported western know-how, and also accepted some western ways in business and finance. This time, however, instead of the preservation of Confucian values, it is worried about the impact of “things foreign” on its Marxist-Leninism ideals. Similarly, now pursuing activism and pragmatism in foreign relations, the People’s Republic is concerned about the necessity and the resulting problem of participation and ultimate integration in international norms and systems.

In terms of uneasiness, the People’s Republic is not alone. At the other end, the West is also trying to cope with the emergence of the PRC from seclusion, and its present policy favoring foreign technology import. Indeed, in relation to civil aviation, until a few years ago western nations like the U.S. have not seriously considered the prospect of selling aircraft or related technology, and operating air services to the PRC. Now that it is no longer wishful thinking, westerners are competing for the China market with zeal and anticipation. As such, there is currently a search for a viable strategy. Hopefully, this study has provided with an answer.

In essence, this study suggests that, in approaching the People’s Republic in the context of reopening of bilateral air services and the transfer of aviation technology, the U.S. must avoid resorting to traditional ways and means. As we have seen, in the case of air transport relations, classical concepts of recognition and state succession are no longer useful. In respect of airlines and aircraft manufacturing, equity joint ventures are out of place. Given that other forms of assistance or cooperative arrangements may be feasible in this industry, the U.S. also cannot pursue its traditional unscrupulous policy of offering
various forms of assistance as a means of gaining entry into, and controlling the airline or aircraft market of a foreign country. As a matter of fact, the PRC leadership is very emphatic about that, as is evident in a recent speech by Shen Tu, presently the Director General of CAAC. While expressing his appreciation of the necessity for providing technical assistance for the developing countries, Shen proceeded to warn western nations: "... We hold that all genuine assistance should be rendered in full respect of the sovereignty and national dignity of the recipient countries, and should aim at helping them develop their civil aviation independently instead of intensifying their dependence on outside assistance. We are firmly opposed to the vicious practice of gaining control under the cover of assistance ..." (emphasis added) 155 Clearly, the times have changed, and so must the old ways.

At the time of writing, changes are already underway. On the American side, for example, McDonnell Douglas has recently come up with an "offset program" in their dealings with the PRC in which they agree to make arrangements in the U.S. (including the necessary credit financing) for American firms to buy Chinese products in consideration of China's decision to purchase their aircraft. 156 Conversely, the Chinese are also altering their ways. Lately, in addition to adopting a more realistic banking and investment policy, the People's Republic has endorsed a "pay-back-with-products" arrangement with foreign firms that will pay for imported equipment and technology, or capital borrowed for that purpose with other export products or products of the importing plant. 157 To both countries, therefore, the key words are

155. ICAO Doc. 9119/a21-Min.P/1-12, at 65-66. The speech was made at the 21st session of the ICAO Assembly, marking the PRC's first participation there.
157. Terrill, supra note 136; Liu, supra note 137. Also the PRC has recently entered into a $127 million land development contract in Hong Kong with two British companies. Far Eastern Econ. Rev., September 8, 1978. In essence, it is a rare PRC joint venture with "foreign" equity participation. The Chinese move, however, was probably politically motivated as a vote of confidence on the future of the British colony for the benefit of local residents and foreign interests. More significantly, the joint undertaking is physically outside of China itself. Thus it does not have any material bearing on a similar venture on aircraft manufacturing in the PRC. Moreover, unlike the "pay-back-with-products" idea, which involves merely export goods and oil, the Chinese here are not dealing with a readily marketable consumer product. Unless the PRC, through joint ventures, is able to produce superior aircraft types which are similarly marketable, there is really no analogy for the Chinese civil aviation industry.
accommodation and cooperation. While they will serve as the guideline in this aspect of U.S.-China rapprochement, their effectiveness, in the long run, will depend on how long the Chinese will maintain this economic pragmatism and how far the U.S. will pursue its even-handed policy toward Taiwan. In the meantime, at least, the outlook of the China market is reasonably good for the U.S. aerospace industry.

By deliberate design, the second part of this study has attempted to re-create, and to relate to China's developmental experiences through a study of the history and problems in the growth of its civil air transport. The underlying hope is that it will offer food for thought as well as insights in other areas of interests in the PRC. For instance, the present subject of civil aviation could have been substituted for the exploration of oil, or other natural resources in China. Alternatively, we may have been concerned with the issue of the People's Republic's participation in international politics, or its general attitude toward international law and trade, or the new international economic order. One thing is certain and common to all the foregoing. We invariably find that in order to understand China's present attitudes on those subjects, we must look beyond its political and ideological philosophizing and rhetoric into problems and values deeply rooted in the past. We also discover that progress in the way of reconciliation with the PRC and many of its concepts can only be attained very gradually, and not without the simmering effect of time.

One can only hope that clashes of interests, objectives and opinions in the past would produce better mutual insight, respect and understanding between the PRC and the U.S. (as well as the world at large) so that conflicts will be minimized now and in the future. Hopefully, through dealing with and understanding the People's Republic, the West will gain valuable perspectives which could help improve its present relationship with other developing Third World countries.
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