

**BENEFITS OF AIR TRANSPORT LIBERALIZATION**  
**TO THE DEVELOPMENT OF SOUTHWEST CHINA**

**REMARKS OF ANDREW B. STEINBERG**  
**ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS**  
**U.S. DEPARTMENT OF TRANSPORTATION**

**BEFORE THE CHINA CIVIL AVIATION FLIGHT UNIVERSITY**  
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THANK YOU, MR. WUXURONG, FOR THAT KIND INTRODUCTION. I ALSO WANT TO THANK THE CHINA CIVIL AVIATION FLIGHT UNIVERSITY FOR PROVIDING US WITH THIS FORUM TODAY AND EVERYONE HERE FOR THEIR TIME, ESPECIALLY ON A FRIDAY AFTERNOON BEFORE A HOLIDAY WEEK. IT IS A DISTINCT HONOR TO BE DISCUSSING AIR TRANSPORT LIBERALIZATION **HERE** -- AT THE VERY SCHOOL CAAC MINISTER YANG HIMSELF ATTENDED. YOUR MINISTER IS A TRUE VISIONARY AND CHINA'S REMARKABLE ADVANCES IN AVIATION ARE A TRIBUTE TO HIS LEADERSHIP AND THAT OF THE ENTIRE CAAC.

SINCE ARRIVING IN CHENGDU ON TUESDAY I HAVE BEEN IMPRESSED NOT ONLY BY YOUR CITY'S WARM HOSPITALITY BUT ALSO BY THE SITES THAT MAKE THIS CITY A TOP TOURIST DESTINATION -- INCLUDING THE WORLD-RENOWNED PANDA BREEDING CENTER AS WELL AS THE NEW JINGSHA MUSEUM, WHICH IS DESTINED TO BECOME ONE OF WORLD'S TRUE ARCHAEOLOGICAL ACHIEVEMENTS . I LOOK FORWARD TO CONTINUING MY TOUR OF CHENGDU

THIS WEEKEND AND – AS SOMEONE WHO ENJOYS SPICY FOOD -- TO MORE OF YOUR SICHUAN CUISINE. .

WHILE YOUR COUNTRY'S HISTORY AND CIVILIZATION GO BACK THOUSANDS OF YEARS (AS I SAW AT JINGSHA MUSEUM), WHEREAS THAT OF THE UNITED STATES GOES BACK JUST TWO HUNDRED, WE HAVE MANY THINGS IN COMMON. AND MY FLIGHT HERE ON FROM BEIJING ON AIR CHINA EARLIER THIS WEEK CONVINCED ME THAT IN THE AREA OF AVIATION OUR TWO COUNTRIES ARE VERY SIMILAR INDEED. I SAW FROM THE AIR THE RUGGED AND BEAUTIFUL TERRAIN – REMINDING ME OF THE AMERICAN SOUTHWEST. OUR TWO COUNTRIES SHARE SEVERAL FEATURES: VAST LAND EXPANSES . . . . . POPULATION CENTERS IN REMOTE PLACES THAT CAN ONLY EFFECTIVELY BE REACHED BY AIR . . . AN ENTREPRENEURIAL SPIRIT . . . AND A DESIRE FOR SUSTAINABLE ECONOMIC DEVELOPMENT BENEFITTING ALL REGIONS. SO CHENGDU IS THE PERFECT PLACE TO DISCUSS THE ROLE OF AVIATION LIBERALIZATION IN THE ECONOMIC DEVELOPMENT OF SOUTHWEST CHINA, JUST AS IT DID IN THE DEVELOPMENT OF THE SOUTHWEST UNITED STATES.

IN THE UNITED STATES, WE OFTEN HEAR ABOUT THE REMARKABLE GROWTH HAPPENING IN CHINA. PERSONALLY, I HAVE BEEN FORTUNATE TO VISIT CHINA FIVE TIMES IN THE LAST YEAR AND A HALF AND THREE TIMES IN 2007 ALONE. THE CHANGE THAT OCCURS IN YOUR COUNTRY EVEN IN THE SPACE OF MONTHS IS TRULY REMARKABLE. IN THE UNITED STATES, NOT A WEEK GOES

BY WITHOUT A NEWSPAPER ARTICLE OR TELEVISION PROGRAM HIGHLIGHTING SOME ASPECT OF CHINA'S RISE AS AN ECONOMIC SUPERPOWER. AND WE DO NOT JUST 'HEAR' ABOUT IT, INCREASINGLY AMERICANS SEE MORE AND MORE VISIBLE SIGNS OF CHINA'S RISE IN OUR DAILY LIVES: OUR STORE SHELVES ARE FULL OF CHINESE GOODS, OUR CHILDREN (INCLUDING MY 14-YEAR OLD DAUGHTER) ARE STUDYING MANDARIN IN SCHOOLS IN RECORD NUMBERS, AND MORE AND MORE AMERICANS ARE DEVELOPING SOCIAL AND BUSINESS CONTACTS WITH CITIZENS OF CHINA.

THE BLOSSOMING RELATIONSHIP BETWEEN OUR TWO COUNTRIES IS ENABLED IN VERY SIGNIFICANT PART BY AIR TRANSPORTATION. MUCH LIKE TELECOMMUNICATIONS, COMMERCIAL AIR TRANSPORT OF PASSENGERS AND CARGO EXISTS PRIMARILY TO FACILITATE OTHER FORMS OF COMMERCE. NO ONE I KNOW BUYS AN AIRPLANE TICKET JUST FOR THE SAKE OF DOING SO, THAT IS, WITHOUT SOME PURPOSE AT HIS DESTINATION; AND NO PACKAGE MOVES BY AIR WITHOUT SOME ULTIMATE COMMERCIAL USE. AIR TRANSPORTATION HAS IN JUST A FEW DECADES ENABLED US TO BECOME CONNECTED ON A SCALE AND ON A SCOPE UNPRECEDENTED IN WORLD HISTORY.

WHILE AVIATION HAS MADE GLOBALIZATION POSSIBLE, IRONICALLY ENOUGH, INTERNATIONAL AIR TRANSPORTATION HAS TRADITIONALLY BEEN ONE OF THE MOST HEAVILY RESTRICTED AREAS OF COMMERCE – WITH STRICT LIMITS ON

FLIGHTS BETWEEN COUNTRIES, THE NUMBER AND IDENTIFY OF AIRLINES IN THE MARKET, THE FARES THEY CAN CHARGE, AND EVEN THE SIZE OF AIRCRAFT. THIS IS BEGINNING TO CHANGE – THE U.S. NOW HAS OVER 70 OPEN SKIES PARTNERS WITH FULLY LIBERALIZED AIR TRANSPORT AGREEMENTS, AND NEXT MONDAY, THE UNITED STATES AND THE EUROPEAN UNION WILL SET A MILESTONE WHEN THEY SIGN AN OPEN SKIES AGREEMENT – LIFTING ARCHAIC REGULATIONS ON TIES BETWEEN THE TWO LARGEST AVIATION MARKETS.

UNFORTUNATELY, OUR AVIATION AGREEMENT WITH CHINA IS OUT OF STEP WITH THE MODERN TREND, THE EXISTING AVIATION AGREEMENT BETWEEN OUR TWO COUNTRIES LIMITS THE FREEDOM AND ABILITY OF CHINESE AND U.S. AIRLINES TO FULLY FACILITATE GROWING COMMERCE AND DEVELOPMENT BETWEEN OUR NATIONS. THERE ARE JUST TEN (10) DAILY FLIGHTS BY U.S. CARRIERS TO CHINA, AND IT IS VERY DIFFICULT, AND EXPENSIVE, TO FIND A SEAT. HAPPILY, THIS WEEK YOUR CAAC AND OUR U.S. DEPT OF TRANSPORTATION AND STATE ARE MEETING HERE IN CHENGDU TO FIND WAYS TO LIBERALIZE THE AGREEMENT. IT'S ABOUT TIME -- IT MAKES NO MORE SENSE TO US TO CONTINUE TO CURTAIL THE NUMBER OF FLIGHTS BETWEEN CHINA AND THE U.S. THAN IT WOULD TO LIMIT THE NUMBER OF PHONE LINES BETWEEN US.

WHAT IS THE SIGNIFICANCE OF THIS TO SOUTHWEST CHINA? FULL AVIATION LIBERALIZATION BETWEEN THE U.S. AND CHINA WILL HELP THE DEVELOPMENT EFFORTS OF CITIES SUCH AS CHENGDU IN WAYS I WILL EXPLAIN. LIFTING THE RESTRICTIONS IN PLACE BETWEEN OUR COUNTRIES WILL MAKE IT COMMERCIALY EASIER TO INCREASE THE FLOW OF PEOPLE AND GOODS BETWEEN CHENGDU AND THE UNITED STATES.

YOU MAY BE AWARE THAT OUR CURRENT AGREEMENT DOES NOT HEAVILY RESTRICT THE FREQUENCY FLIGHTS BETWEEN THE UNITED STATES AND CHENGDU. IN FACT THE AGREEMENT ALLOWS U.S. CARRIERS TO FLY TO CHENGDU TODAY WITH RELATIVELY FEW RESTRICTIONS -- BUT NO AMERICAN CARRIER HAS YET ELECTED TO DO SO. IT IS NOT A MATTER OF WILLINGNESS ON THE PART OF US CARRIERS -- IT IS A RESULT OF THE UNDERLYING ECONOMICS OF AIR TRANSPORTATION, CURRENT MARKETPLACE CONDITIONS, AND THE NATURE OF OUR EXISTING BILATERAL AVIATION AGREEMENT.

THERE ARE TWO FUNDAMENTAL ISSUES THAT DISCOURAGE U.S. AIRLINES FROM INITIATING SERVICE TO CHENGDU AND SIMILAR CITIES IN SOUTHWEST CHINA DIRECTLY FROM THE UNITED STATES: AIRLINE ECONOMICS AND PHYSICAL GEOGRAPHY.

THE DIRECT COSTS OF OPERATING WIDE-BODY AIRCRAFT BETWEEN THE UNITED STATES AND CHINA ARE QUITE HIGH. FURTHER, THE VERY LONG

FLIGHT TIMES BETWEEN OUR COUNTRIES MEAN DEDICATING AT LEAST TWO AIRCRAFT PER ROUTE TO SUPPORT THE PATTERN OF DAILY SERVICE FAVORED BY U.S. CARRIERS. BECAUSE OF THE SIGNIFICANT INVESTMENT AND ACCOMPANYING FINANCIAL RISKS ASSOCIATED WITH THESE FLIGHTS, OUR CARRIERS HAVE BEEN FOCUSED ON SERVING CHINA -- AT LEAST INITIALLY-- VIA BEIJING AND SHANGHAI, THE MOST POPULAR POINTS OF ENTRY TO CHINA FOR U.S.-ORIGINATING PASSENGERS. WE SEE THE SAME PHENOMENON IN THE OTHER DIRECTION: CHINESE CARRIERS INITIATED SERVICE TO THE U.S. BY FLYING TO NEW YORK, LOS ANGELES AND SAN FRANCISCO AND NOT OTHER IMPORTANT COMMERCIAL CENTERS IN THE U.S. LIKE HOUSTON OR DALLAS/FORT WORTH.

TO BE SURE-- THERE IS SOME DEMAND FOR AIR SERVICE BETWEEN THE UNITED STATES AND CHENGDU. MAJOR COMPANIES LIKE COMPUTER-CHIP MAKER INTEL CORPORATION HAVE MADE LARGE INVESTMENTS IN CHENGDU. BUT IN ORDER TO PROFITABLY MEET THIS DEMAND FOR AIR TRANSPORTATION BETWEEN CHENGDU AND THE UNITED STATES, U.S. AIRLINES MUST ADD CAPACITY THAT CORRESPONDS TO DEMAND. IN THE CASE OF CHENGDU, WITH SIGNIFICANTLY FEWER THAN 100,000 TRUE ORIGIN AND DESTINATION PASSENGERS EACH YEAR TO THE U.S. -- THE MOST APPROPRIATE AIRCRAFT IN TERMS OF SEAT COUNT AND CARGO CAPACITY WOULD BE THE NARROWBODY BOEING 737 OR AIRBUS 320. AS YOU KNOW, THESE AIRPLANES ARE NOT CAPABLE OF OPERATING INTERCONTINENTAL ROUTES AND IT IS

UNECONOMICAL FOR US AIRLINES TO BASE THESE SIZE AIRCRAFT AND CREWS IN ASIA.

WHEN U.S. CARRIERS DECIDE WHERE TO USE LONG-RANGE AIRCRAFT, THEY COMPARE OPPORTUNITIES AROUND THE WORLD AND BECAUSE OF THE HEAVY INVESTMENT INVOLVED IN INTERNATIONAL SERVICE FOCUS ON ROUTES THAT ARE MOST LIKELY TO BE PROFITABLE. AS IT STANDS, THE COMMERCIAL CASE FOR SERVING CITIES SUCH AS CHENGDU FROM THE UNITED STATES IS NOT YET RIPE, EVEN FOR OPERATIONS OVER INTERMEDIATE POINTS. WHILE THAT COULD CHANGE OVER TIME, IT WILL DEPEND VERY HEAVILY ON HOW MUCH FREEDOM U.S. AND CHINESE AIRLINES HAVE IN DEVELOPING THE MARKETPLACE IN COMING YEARS.

THE NATURE OF AIRLINE ECONOMICS IS SUCH THAT THE BEST WAY TO ATTRACT U.S. TOURISTS AND BUSINESSMEN TO COME TO CHENGDU TODAY IS TO ALLOW U.S. CARRIERS MORE FREEDOM TO SERVE CITIES SUCH AS BEIJING AND SHANGHAI TODAY. THE REASON FOR THIS LIES IN THE HUB AND SPOKE SYSTEM THAT PROVIDES THE BUSINESS MODEL FOR ALL MAJOR U.S. AIR CARRIERS. 'AFTER THE UNITED STATES DEREGULATED THE INDUSTRY, MOST AIRLINES QUICKLY ADOPTED WHAT IS KNOWN AS A HUB-AND-SPOKE MODEL. THE LOGIC IS SIMPLE: THERE IS NO BETTER WAY TO SERVE A NETWORK OF CITIES. JUST CONSIDER THIS MATHEMATICAL EXAMPLE: IF AN AIRLINE OPERATED TO 25 CITIES AND WANTED TO CONNECT THEM POINT-TO-POINT,

THEY WOULD NEED TO FLY OVER 300 ROUNDTRIPS EVERY DAY. BUT BY SETTING UP A HUB-AND-SPOKE MODEL, THEY COULD DO SO WITH AS FEW AS 24 ROUNDTRIPS PER DAY!

ON A GIVEN FLIGHT TO A CONNECTING HUB IN THE UNITED STATES – AIRPORTS LIKE DALLAS/FT WORTH, SALT LAKE CITY, AND PHOENIX -- TYPICALLY LESS THAN HALF OF THE PASSENGERS WILL BE DESTINED FOR THE HUB CITY ITSELF. RATHER, THE MAJORITY WILL BE CONNECTING AT THE HUB DESTINED TO ANOTHER POINT BEYOND THE HUB. IN THIS WAY, THE HUB ALLOWS AN AIRLINE EFFICIENTLY TO AGGREGATE DEMAND FOR AIR TRANSPORTATION TO EACH PARTICULAR CITY FROM ACROSS ITS ENTIRE NETWORK AND THEREBY TO MINIMIZE THE CAPITAL EXPENSES, SUCH AS AIRCRAFT, AND OPERATING EXPENSES, SUCH AS JET FUEL, NEEDED TO PROVIDE THIS SERVICE AND MAKE A PROFIT. AT THE SAME TIME THE MOST SUCCESSFUL HUBS, HOWEVER, ARE LOCATED AT CITIES WITH THE GREATEST AMOUNT OF LOCAL TRAFFIC, BECAUSE THEY CAN FILL UP THE SEATS NOT TAKEN BY CONNECTING PASSENGERS.

AT THE PRESENT STAGE, THE MOST LOGICAL WAY TO MOVE PASSENGERS AND CARGO EFFICIENTLY BETWEEN CHENGDU AND THE UNITED STATES IS TO MOVE THEM THROUGH ANOTHER HUB IN CHINA – SUCH AS BEIJING, SHANGHAI, GUANGZHOU. BUT OUR CURRENT BILATERAL AGREEMENT SEVERELY RESTRICTS THE NUMBER OF FLIGHTS FROM THE U.S. TO BEIJING, SHANGHAI



AND GUANGZYU. SO THE EFFECT OF THE RESTRICTIONS IS TO LIMIT THE POOL OF PASSENGERS WHO WOULD POTENTIALLY TRAVEL NOT TO JUST THOSE TWO CITIES BUT ALSO THOSE WOULD CONNECT TO CHENGDU AND MANY OTHER CITIES. SO, FROM OUR POINT OF VIEW, CITIES IN SOUTHWEST CHINA COULD MORE EASILY ATTRACT INVESTMENT AND TOURISM FROM THE UNITED STATES IF THERE WERE MORE FLIGHT OPTIONS TO THE MOST POPULAR GATEWAYS IN CHINA FROM CONNECTING HUBS IN THE UNITED STATES.

IN THE LONGER-TERM LIFTING RESTRICTIONS AT BEIJING AND SHANGHAI WILL HELP CHENGDU DEVELOP INTERNATIONAL AIR SERVICE OF ITS OWN. LET ME EXPLAIN. THIRTY YEARS AGO INTERNATIONAL AIR SERVICE TO THE UNITED STATES WAS ALMOST EXCLUSIVELY CONCENTRATED IN THE LARGE CITIES SUCH AS NEW YORK, LOS ANGELES, AND CHICAGO. AS THE U.S. LIBERALIZED ITS ARRANGEMENTS WITH OTHER COUNTRIES, THIS CHANGED SIGNIFICANTLY.

TODAY SMALLER CITIES THAT WERE ONCE ESSENTIALLY RURAL NOW HAVE INTERCONTINENTAL SERVICE TO EUROPE AND ASIA AND SOMETIMES EVEN HAVE THEIR OWN AIRLINES HUBS. HERE IS JUST A PARTIAL LISTING OF SUCH CITIES: CHARLOTTE, NORTH CAROLINA; CINCINNATI, OHIO; MEMPHIS, TENNESSEE; AND PHOENIX ARIZONA (THE SISTER CITY TO CHENGDU. ALL OF THESE CITIES ARE MUCH, MUCH SMALLER THAN CHENGDU. OF COURSE, EVEN LARGER AMERICAN CITIES SUCH AS HOUSTON, TEXAS AND ATLANTA, GEORGIA

WERE ONCE LIMITED TO PRIMARILY DOMESTIC SERVICE AND NOW HAVE GLOBAL AIR SERVICE. THE CHANGES ARE TRULY DRAMATIC IN OUR COUNTRY.

LET'S TAKE THE EXAMPLE OF CINCINNATI, OHIO, WHICH IS LOCATED IN THE MIDWESTERN PART OF THE U.S. TODAY, THERE ARE 5 DAILY NONSTOP FLIGHTS ON DELTA AIRLINES TO EUROPE FROM CINCINNATI—EACH TO A DIFFERENT CITY. (ROME, PARIS, FRANKFURT, AMSTERDAM, AND LONDON) HOWEVER MOST OF THE PASSENGERS ON BOARD THOSE FLIGHTS NEITHER LIVE IN CINCINNATI NOR HAVE PLANS TO SPEND TIME THERE. THE NUMBER OF CINCINNATI-AREA RESIDENTS TRAVELING TO EUROPE PROBABLY CANNOT JUSTIFY EVEN A SINGLE DAILY FLIGHT TO ANY CITY IN EUROPE. BUT BECAUSE DELTA AND ITS ALLIANCE PARTNERS CAN AGGREGATE DEMAND AT THE CINCINNATI HUB, THE CITY ENJOYS BOUNTIFUL INTERNATIONAL SERVICE THAT WOULDN'T OTHERWISE EXIST -- A BOON TO THE LOCAL ECONOMY.

EARLIER IN MY CAREER, I WORKED FOR AMERICAN AIRLINES AND LIVED IN DALLAS, TEXAS. DALLAS AND NEARBY FORT WORTH BENEFITTED ENORMOUSLY FROM THE HUB AT DFW INTERNATIONAL AIRPORT. THE NUMBERS ARE ASTOUNDING: THE AIRPORT GENERATES \$14.3 BILLION IN ANNUAL ECONOMIC ACTIVITY, SUPPORTS 268,500 JOBS, WITH A PAYROLL OF \$6 BILLION. THANKS IN LARGE PART TO THE AIRPORT, THE AREA NOW KNOWN AS THE 'DFW METROPLEX' HAS AN ECONOMY THAT IS ALMOST THE SIZE OF

INDONESIA AND IS ACTUALLY LARGER THAN THE ECONOMIES NORWAY, DENMARK, AND IRELAND.

AIRLINES HUBS ARE MAGNETS FOR OTHER BUSINESSES. THERE IS AMPLE EVIDENCE INDICATING CORPORATIONS OFTEN CHOOSE WHERE TO LOCATE NEW FACTORIES OR OPERATIONS BASED ON THE AVAILABILITY OF AIR SERVICE. INDEED ONE STUDY CITED BY IATA FOUND THAT EVEN A MODEST 10-PERCENT INCREASE IN INTERCONTINENTAL FLIGHTS IN A CITY LEADS TO A MEASURABLE INCREASE IN THE NUMBER OF CORPORATE HEADQUARTERS LOCATED IN THE ADJACENT URBAN AREA. FURTHER THE SAME STUDY FOUND KNOWLEDGE-INTENSIVE, PROFESSIONAL SECTORS – WITH HIGH PAYING JOBS - - ARE MUCH MORE INFLUENCED BY THE SUPPLY OF DIRECT INTERCONTINENTAL FLIGHTS THAN OTHER SECTORS. IN 2005 ALONE, THE DFW METROPLEX SAW OVER 300 COMPANIES RELOCATE OR EXPAND IN THE AREA AND INVEST \$3 BILLION IN THE PROCESS. AND YET ANOTHER IATA STUDY INDICATES THAT COMPREHENSIVE AIR TRANSPORTATION CAN SPUR CORPORATE INNOVATION. HAVING GOOD AIR TRANSPORT LINKS MEANS LOCAL COMPANIES CAN REACH MORE MARKETS AND SPREAD THE FIXED COSTS OF R&D OVER LARGER SALES.

SO THE WAY TO ENCOURAGE DIRECT SERVICES TO CITIES LIKE CHENGDU IN THE LONG TERM – AND THUS TO HELP YOUR ECONOMY GROW -- IS TO FACILITATE AND ENCOURAGE EFFICIENT ONE-STOP SERVICES IN THE SHORT-

TERM FROM OTHER CHINA GATEWAYS. OVER TIME, OF COURSE, GIVEN ITS STRATEGIC LOCATION, INDUSTRIAL BASE, TOURIST ATTRACTIONS, AND LARGE POPULATION, I WOULD EXPECT CHENGDU TO BECOME A HUB ON ITS OWN.

THE SAME HOLDS TRUE FOR AIR CARGO HUBS. THE WORLD'S LARGEST AIR CARGO HUB IS BASED IN MEMPHIS, TENNESSEE—HOME OF FED EX. NOT TOO FAR AWAY IN LOUISVILLE, KENTUCKY, UNITED PARCEL SERVICE OPERATES THE WORLD'S 8<sup>TH</sup> LARGEST CARGO HUB. NEITHER MEMPHIS NOR LOUISVILLE WERE HISTORICALLY LARGE MANUFACTURING CENTERS THAT WOULD REQUIRE SUPPORT THE MASSIVE AMOUNTS OF CARGO LIFT PROVIDED BY THESE EXPRESS COMPANIES. BUT GEOGRAPHY MADE THESE CITIES IDEAL PLACES FOR LOCATING HUBS. IN THE CASE OF THE LOUISVILLE UPS HUB, 42% OF THE US POPULATION RESIDES WITHIN 500 MILES OF THESE HUBS AND ALL CITIES ON THE EAST COAST CAN BE REACHED WITHIN 2.5 HOURS AND ALL CITIES ON THE WEST COAST CAN BE REACHED WITHIN 3.5 HOURS. THE EXISTENCE OF THESE HUBS HAS SPAWNED THE CREATION OF NEW BUSINESS VENTURES AND ATTRACTED OTHER BUSINESSES TO THESE CITIES. FOR INSTANCE, MANY COMPANIES HAVE LOCATED WAREHOUSING AND LOGISTICS CENTERS IN MEMPHIS TO AVAIL THEMSELVES OF THE MASSIVE NEARBY FED EX HUB. HUBS CLEARLY BENEFIT LOCAL ECONOMIES. IT CAN OFTEN BE A MATTER OF SIMPLY TAKING ADVANTAGE OF FAVORABLE GEOGRAPHY.

IN EUROPE, THE STORY IS VERY SIMILAR. CITIES SUCH AS BRISTOL IN THE UNITED KINGDOM, NICE IN FRANCE AND COLOGNE IN GERMANY HAVE DIRECT SERVICES TO THE UNITED STATES THAT WOULD NEVER HAVE BEEN COMMERCIALY VIABLE WITHOUT AIRLINE HUBS. THESE SERVICES ONLY CAME TO FRUITION BECAUSE AIRLINES WERE FREE TO MAKE BUSINESS DECISIONS IN RESPONSE TO MARKET CONDITIONS OVER THE LONG TERM. THE MARKET ECONOMY, NOT GOVERNMENT DIRECTION, PRECIPITATED THESE BENEFICIAL SERVICES.

GIVEN A CHANCE, THE SAME PHEONOMENON WILL PROVE TRUE FOR CHINA AND BENEFIT STRATEGICALLY LOCATED CITIES LIKE CHENGDU. AGAIN THE KEY FACTOR IN THESE SUCCESS STORIES WAS THAT AIRLINES WERE GIVEN THE FREEDOM TO DEVELOP THE MARKET AND SELECT ROUTES, AIRCRAFT FREQUENCIES AND SO FORTH.

IN THE TYPICAL PATTERN OF AIR SERVICE DEVELOPMENT, INTERNATIONAL AIRLINES BEGIN WITH SERVICES BETWEEN MAJOR CITIES THAT PROVIDE A BASE LEVEL OF SUPPLY AND DEMAND FOR AIR SERVICE BETWEEN TWO COUNTRIES. ONCE THEY ARE ESTABLISHED IN THE MARKETPLACE, AIRLINES THEN CONSIDER TAKING BUSINESS RISKS AND EXPLORE SERVICE TO NEW CITIES AS THE ECONOMIC RELATIONSHIP BETWEEN THE TWO COUNTRIES BROADENS AND DEEPENS. SERVICES TO CITIES SUCH CHARLOTTE OR PORTLAND IN THE UNITED STATES AND NICE AND COLOGNE IN EUROPE HELPS

AIRLINES **DIFFERENTIATE** THEIR NETWORKS FROM THOSE OF THEIR COMPETITORS. INDEED MANY US CARRIERS HAVE ADOPTED SUCH AS A STRATEGY HAVE FOCUSED INTERNATIONAL GROWTH ON SMALLER EUROPEAN CITIES BUT ONLY AFTER FIRST SERVING THE LARGER ONES.

THE U.S.-GERMANY MARKET PROVIDES A USEFUL EXAMPLE. IF YOU LOOK AT DATA FOR THE MARKET OVER THE PAST 10 YEARS DURING THE MONTH OF JULY -- TYPICALLY A PEAK PERIOD—WHAT YOU FIND IS THAT THE NUMBER OF FLIGHTS AND MARKETS SERVED HAS INCREASED DRAMATICALLY. IN THE MONTH OF JULY 1997, THERE WERE 1457 FLIGHTS BETWEEN THE US AND GERMANY CONNECTING 34 MARKETS. THIS JULY, THERE ARE 2197 FLIGHTS THAT WILL CONNECT 47 MARKETS, A FIFTY PERCENT INCREASE. ALL OF THESE ADDITIONAL FLIGHTS AND NEW MARKETS CREATE MORE OPPORTUNITIES FOR COMMERCE, TOURISM, AND CULTURAL EXCHANGE. THERE IS NO REASON WHY CHINA WOULD NOT SEE SIMILAR BENEFITS AT THE MARKET BECOMES MORE LIBERALIZED.

IN ADDITION TO ALLOWING U.S. CARRIERS THE NECESSARY ACCESS TO SERVE BEIJING AND SHANGHAI, OTHER WAYS EXIST FOR CHINA TO BOLSTER SERVICE TO CITIES LIKE CHENGDU. U.S. AIRLINES PARTICIPATE IN GLOBAL ALLIANCES SUCH AS ONEWORLD, STAR, AND SKYTEAM. THEY ENTER THESE ALLIANCES SO THEY MAY SERVE DISTANT CITIES THEY CANNOT SERVE INDEPENDENTLY BY LEVERAGING THE COMPLEMENTARY NETWORKS OF PARTNERS BASED IN

ASIA, EUROPE, AND OTHER PARTS OF THE WORLD. IN ADDITION TO THEIR PARTNERS IN CHINA, U.S. CARRIERS ALSO HAVE PARTNERSHIPS WITH AIRLINES IN JAPAN AND SOUTH KOREA WITH WHOM THEY COULD COOPERATIVELY TRANSPORT PASSENGERS AND CARGO BETWEEN CITIES LIKE CHENGDU AND THE UNITED STATES. THESE CARRIERS HAVE THE RIGHT-SIZED AIRCRAFT BASED AT RELATIVELY CLOSE-BY HUBS IN SEOUL AND TOKYO OPERATING TO CITIES THROUGHOUT CHINA. IF U.S. PASSENGERS AND BUSINESS PEOPLE COULD CONNECT TO THESE FLIGHTS, MORE OF THEM WOULD COME TO PLACES IN CHINA BESIDES BEIJING AND SHANGHAI. THUS, A SHORT-TERM WAY TO INCREASE THE NUMBER OF INTERNATIONAL VISITORS TO CHENGDU IS TO PERMIT THESE KINDS OF ALLIANCE SERVICES OVER THIRD COUNTRIES.

LET ME CONCLUDE BY SUMMARIZING. DEVELOPMENT OF INTERNATIONAL AIR SERVICE TO REGIONAL CITIES IN CHINA HAS TO BEGIN WITH LIBERALIZED ACCESS FOR INTERNATIONAL AIRLINES TO THE MAJOR DESTINATIONS IN CHINA—NAMELY BEIJING AND SHANGHAI. THE NATURE OF AIRLINE ECONOMICS IS SUCH THAT CITIES SUCH AS CHENGDU ARE MOST EFFICIENTLY SERVED THROUGH HUBS IN ASIA UNTIL SUCH TIME AS THE MARKET CAN SUPPORT NON-STOP SERVICE DIRECTLY FROM THE UNITED STATES. IT IS OUR HOPE THAT US AND CHINESE AIRLINES WILL SOMEDAY COMMENCE NON-STOP SERVICE BETWEEN CHENGDU AND THE UNITED STATES. IN FACT, I HOPE TO BE A PASSENGER ON BOARD ONE OF THEM. IN THE MEANTIME, AIRLINE ALLIANCES CAN HELP FILL THE GAP.

I WANT TO LEAVE YOU WITH THIS THOUGHT: CHINA AND THE UNITED STATES SHARE THE GOAL OF FULLY LIBERALIZING OUR AVIATION RELATIONSHIP. THIS WEEK, NEGOTIATORS FROM BOTH COUNTRIES WORKED HARD TO SEE IF WE CAN FIND A WAY TO ACHIEVE THAT GOAL. THE ENCOURAGEMENT OF THE CAAC TO HOLD THESE HISTORIC TALKS IN CHENGDU IS RECOGNITION OF THE IMPORTANCE THAT AIR TRANSPORTATION LIBERALIZATION WILL PLAY IN THE ECONOMIC DEVELOPMENT OF SOUTHWEST CHINA, AS CITIES LIKE THIS ONE CREATE AIRLINE HUBS. AND HAVING THESE TALKS IN SUCH A BEAUTIFUL, AND WELCOMING, LOCATION GIVES US EVEN GREATER IMPETUS TO REACH AN AGREEMENT THAT WILL BENEFIT BOTH COUNTRIES.

THANK YOU AND I WOULD BE PLEASED TO TAKE ANY QUESTIONS.