

“TRADE IN SERVICES: OPPORTUNITIES AND CONSTRAINTS”

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Report on
TRADE IN AIR TRANSPORT SERVICES

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Introduction

Air transport services include a wide range of activities including aircraft repair and maintenance, computerized reservations, civil aviation, air cargo and freight related services. India is a marginal player in the world air transport industry, accounting for a small share of airline passenger and cargo services, repair and maintenance, and other activities in this sector.

The international air transport sector has been governed by the ICAO since 1944. Under the ICAO, liberalization in air transport services has taken place via air service agreements between countries on a bilateral basis. Countries have negotiated bilaterally at the pace desired in important areas such as market access, in accordance with their national priorities and interests. The existing international framework has on the whole been successful, enabling a manifold increase in the size of the global air transport sector over the past fifty years.

The General Agreement on Trade in Services creates possibilities for liberalizing trade in air transport services under a multilateral framework of rules and disciplines. Given the existing system of bilateral agreements, it is important to assess the advantages and limitations to liberalizing trade in this sector under GATS.

Structure and objectives

This paper analyses the prospects for liberalizing trade in air transport services, not only from the perspective of the Indian aviation industry but also from that of the tourism industry because of the linkages between the two industries. It looks at the costs and benefits of liberalizing under the GATS framework.

Section 1 discusses the nature of the air transport services sector, globally and within India. It notes the main regulatory and institutional features as well as recent trends and developments in this sector. A model is also presented in this section to explain the cost and benefit to the tourism and aviation industry of having additional 1 million visitors arrive in India per annum. Section 2 discusses the main domestic and external constraints to trade in air transport services. Section 3 provides an overview of the coverage of this sector and the commitments made thus far in this sector under GATS. It also notes the implications of these commitments, in general, and for India. Section 4 highlights India's position on liberalizing trade in this sector during the upcoming WTO negotiations on services in 2000. It notes India's position on areas in this sector that are already covered by GATS, on the inclusion of additional core areas and issues in this sector under GATS, and more broadly, on the issue of bilateralism versus multilateralism in air transport services. It also highlights India's strategy on various other issues of interest in India's negotiations with other countries. Section 5 discusses the regulatory, structural, and other reforms required in India to meet the challenges and opportunities arising from trade liberalization in air transport services, bilaterally or multilaterally.

1. Overview of Air Transport Services

1.1 Air transport services in the world economy

The international regulatory system for the air transport industry has its origins in the Chicago Conference of 1944, which has 85 signatories. The Chicago Conference enshrined the four basic principles of international aviation regulation, namely,

sovereignty, equal opportunities, non-discrimination, and freedom to designate. In regard to each of these principles, respectively, the convention states that each state has complete and exclusive sovereignty over the air space above its territory; that international civil regulation must take due account of the equal rights of all states to participate in air traffic; that international aviation regulation must be without distinction as to nationality; and that each state has complete freedom to designate the national airlines which will operate air services.

The Chicago conference also led to the establishment of the two main institutions governing global air transport services. The first institution was the International Civil Aviation Organisation (ICAO); a multilateral body supported by civil aviation ministries of governments worldwide. ICAO is concerned with technical, safety and security related issues and has to date been a very effective agency in dealing with these areas. The second institution was the International Air Transport Association (IATA), a multilateral body supported by the worlds' airlines. IATA has been successful in obtaining multilateral agreement on a wide range of commercial issues, including tariff agreements, travel agent commissions, management of a uniform global distribution system, interlinking arrangements between airlines of different countries, operation of a clearing house for global settlement of inter-airline accounting, and travel agency billing and settlement.

Since 1944, liberalization of global air transport services occurs through a system of bilateral air service agreements (ASAs), which also has its origins in the Chicago Conference. The main principle underlying these ASAs is the concept of sovereignty over air space of a country's territory. The six "Freedoms" of the air, set out in the International Air Transport Agreement are exchanged through a bilateral bargaining process under these ASAs. These are: -

- ✳ The first 'Freedom' – the privilege to fly across the territory of another State without landing.
- ✳ The second 'Freedom' – the privilege to land for non traffic purposes.
- ✳ The third 'Freedom' – to put down passengers, mail and cargo taken on in the territory of the State whose nationality the aircraft possesses.
- ✳ The fourth 'Freedom' – the privilege to take on passengers, mail and cargo destined for the territory of the State whose nationality the aircraft possesses.
- ✳ The fifth 'Freedom' – the privilege to take on passengers, mail and cargo destined for the territory of any other contracting State and the privilege to put down passengers, mail and cargo coming from such territory.
- ✳ The sixth 'Freedom' – the privilege to carry traffic between the home country to another country by way of any intermediate country with which there is already an agreement on Third and Fourth Freedom traffic rights. (This is sometimes described as adding together two sets of Third & Fourth Freedom rights and an example might be the carriage of traffic by a Dutch airline from London, via Amsterdam to Athens.

The various safeguards available under the Air Services Agreements negotiated bilaterally are as follows:

- (a) The benefits flowing from the Agreements accrue to the designated carriers and therefore to the Contracting Parties or their nationals since the former has to be substantially owned and effectively controlled by the latter.
- (b) The Aeronautical Authorities can suspend the operations of a foreign carrier if that carrier does not meet the “substantial ownership and effective control” clause or if the carrier fails to comply with the applicable laws and regulations.
- (c) The principle of “national treatment” applies vis-a-vis user charges at airports, for customs duties and procedures and also in the applications of customs, immigration, quarantine and similar regulations. In short, the foreign carriers are assured that the national carriers are not given any preference.
- (d) The principle of reciprocity is enshrined in all bilaterals and works as a safeguard since a country need not confer a benefit that it does not reciprocally enjoy.
- (e) The designated carriers of both sides have fair and equal opportunity while operating the agreed services and are required to take into account the interests of the airlines of the other side so as not to unduly affect the latter’s services on the same route.
- (f) The tariff approval procedure given in the bilateral provides a control on the fares charged.
- (g) The procedure for settlement of disputes takes care of matters related to interpretation or application of the Agreements through negotiations between the parties, failing which through arbitration. India has not resorted thus far to arbitration to settle any bilateral disputes on air services matters.

The bilateral system incorporates the concepts of transparency and national treatment that are integral to the GATS framework, though with certain qualifications. The principle of transparency applies to government rules and regulation issued by civil aviation authorities and not to commercial agreements that are confidential to the parties involved. The principle of national treatment is applicable to a wide range of ‘soft rights’ including taxation, airport and route charges, fuel pricing, ground handling, access to reservation systems, sales, marketing, etc. Although the term national treatment is rarely used, in most bilateral agreements, the “doing business arrangements” have established fair and reciprocal rights to non-discriminatory treatment with regard to soft issues. However, most airlines have remained staunchly opposed to conferring national treatment to hard rights, i.e., market access and capacity entitlements due to the treatment of air space over the country as sovereign territory. This position is likely to continue to hold for any carrier that is substantially foreign owned or controlled, excepting cases where countries have a common understanding on mutual interests in the economic, political, and security arena. Thus progress in the area of national treatment within the bilateral agreements framework has so far been confined to agreements between the US and Canada between Australia and New Zealand, and within the EU under various economic integration agreements among these groups of countries.

Over the years, as bilateral agreements have proliferated, sovereignty of a country’s airspace has been secured through airline ownership and control requirements causing a proliferation of national air carriers. The latter trend has in turn required bilateral agreements to include regulations on capacity and dual approval of air tariffs in order to

protect these national carriers from capacity dumping and price wars. Regulations on capacity and tariffs act as safeguards to give all airlines, especially the smaller ones, a fair and equal opportunity to operate international air services.

Thus, the international regulatory environment in air transport services has been a combination of a multilateral framework for establishing technical, operational, and commercial policies and procedures through ICAO and IATA and a bilateral framework for country to country exchange of air traffic rights via the ASAs. Under the bilateral system, capacity has been tightly controlled through the progressive and gradual exchange of traffic rights while prices have been coordinated by IATA. Therefore, given similar routes, similar equipment, and similar prices, the current international regulatory framework in air transport services limits the scope for competition to mainly service related aspects. The system also includes safeguards to provide safety nets for developing country airlines in a liberalizing environment.

Overall, the combination of bilateralism within a multilateral setup has worked effectively. This is evident from the phenomenal growth in the industry (a 250-fold increase in passenger traffic since 1944) and from the high levels of technical competence and safety that have been realized in air transport services.

However, increasingly, the bilateral regulatory system has been subject to intense pressure for change. The forces underlying this change include deregulation and liberalisation, marketing advantages of very large airlines, mergers and alliances, global computerized reservations systems (CRS) and communication systems, recognition of the importance of tourism as a global and 'two-way' commercial activity, increased acceptance of foreign ownership, and moves towards a multilateral system. In particular, the US Deregulation Act of 1978 followed by the entry of the US megas into the international arena has been a major factor forcing change in the international air transport industry. The US airlines with their powerful marketing tools, including CRS, Frequent Flier Programs, and Hub and spoke network have totally transformed the international market place making size a critical factor for success.

The US has pushed for liberalisation of the industry on all fronts, initially with a call for a Global Multilateral and failing this by signing a string of 'Open Skies' bilaterals around the world.¹ In response to the threat of US competition, countries have engaged in restructuring their airlines or have permitted their airlines to forge strategic alliances with US partners. In sum, the various pressures for change have caused the airline industry to become transnational in character and ownership and to be dominated by a small number of very large airlines with global networks and communications system. There are also the beginnings of moves towards plurilateral agreements among like minded countries in some areas. The most striking examples of these are countries in the EU and the Andean group of countries.

¹ An "open sky" agreement means removal of all existing controls on the commercial aspects of operation of air services. Operations are permitted without any restrictions on the number of airlines, frequency of services, aircraft type, type of service terminating or transiting, market access and tariffs. The concerned airlines have to fulfil the conditions that are prescribed under the laws and regulations applied by the country's Aeronautical Authorities to the operation of international air services.

1.2 Air transport services in the Indian economy

India's international air services are provided by Air India and Indian Airlines (both of which are public sector undertakings) and by a host of foreign carriers. Infrastructure facilities at airport terminals are provided by a non-governmental organization, namely, the Airport Authority of India (AAI). Domestic air services are provided by Indian Airlines and several private airlines such as Jet Airways and Sahara. Therefore, neither the international nor the domestic segments of this sector are subject to complete monopoly by an individual airline.

Air India is India's national flag carrier and is the main airline so far as servicing the international routes is concerned. The staff strength of Air India is around 18,700. When Air India had started operations it just covered 3 destinations. Today it covers around 44 destinations. Air India's fleet consists of 26 aircraft. There are six Boeing 747-400, seven Boeing 747-200, 2 Boeing 747-300 Combi, eight Airbuses 310-300 and three Airbus 300-B4. Air India also has plans for the purchase of Medium Capacity Long Range aircraft for induction by the turn of the century.

The other airline servicing the domestic route is Indian Airlines. It was started on 1st August 1953, following the amalgamation of eight private airlines. Today, Indian Airlines, along with its subsidiary airline, Alliance Air, provides an extensive network, which encompasses the whole of India - a geographical area equivalent to Western Europe, besides reaching out to 17 International Stations. There has been a significant increase in the scale of operations of Indian Airlines since its inception. The number of passengers carried has increased from 0.5 million in 1954-55 to 8.4 million in 1997-98. However, the provisional estimates for 1998-99 shows a marginal decline to 8.0 million. The spread of network has increased from 23,000 kilometres in 1953 to 1,18,000 kilometres in 1997-98. Total assets have grown to Rs 31,000 million from modest Rs 21 million in 1954-55. There has also been a manifold increase in the system's seat capacity from 3070 seats per day in 1955 to 35,700 seats per day.

The total earnings of Indian Airlines in foreign currency reached a level of Rs 12564.8 million out of which Rs. 11500 million was from passage sales and Rs. 315 million was from Cargo. The total operating revenue of Indian Airlines in 1997-98 was Rs 32434.5 million while total operating expense was Rs 29845.6 million thereby leaving an operating profit of Rs 2588.9 million.

The main regulatory authorities in the air transport services sector include the Ministry of Civil Aviation, Office of the Director General of Civil Aviation (DGCA) and the Airports Authority of India (for slots).²

Since the 1990s, India has significantly liberalized the regulatory environment in air transport services. In 1990, India liberalized its Civil Aviation policy. An important element in this liberalisation was the adoption of an open skies policy for cargo. The main features of this policy include:

1. International airlines were allowed to make decisions on operation and tariffs for cargo services. This open skies policy for cargo operations was placed on a permanent basis in order to facilitate cargo carriers in making their investment decisions and undertaking long term commitments.

² Details of private participation by domestic service providers as well as existing regulations have to be obtained from the DGCA and added to this paper.

2. Cargo flights could be cleared freely from airports where customs/ immigrations facilities are available Scheduled and non-scheduled operators, both Indian and foreign, could submit application/proposal to the Director General of Civil Aviation for getting clearances for such flights. Cargo flights into India were also permitted.
3. The government would give favourable consideration to private operators, associations of exporters etc., to run air cargo operations on their own or on a consortium basis through purchased or leased freighter aircraft.
4. Carriers were free to charge rates according to the demand and supply situation.
5. Operators were required to meet operational and safety requirements while operating adhoc cargo flights.

State monopoly of scheduled air transport services was terminated in March 1994 by repealing the Air Corporation Act of 1953. More recently, a policy on private investment in the civil aviation industry has been announced which allows 100 percent NRI equity and 40 percent foreign equity participation in domestic airlines. The Domestic Air Transport Policy approved by the government similarly provides for foreign equity participation upto 40% and investment by Non Resident Indians (NRIs)/Overseas Corporate Bodies (OCBs) upto 100% in domestic air transport services. Foreign airlines are, however, not permitted to pick up equity directly or indirectly.

Other policy measures that are under consideration in this sector include measures directed at modernisation of air traffic services, installation of air surveillance radar at certain airports, development of 12 model airports for upgradation of facilities, and improvement in the quality of services

Nevertheless, despite some steps towards liberalization and reforms in this sector, the industry remains uncompetitive and below its potential in its domestic as well as its international operations. Inefficiencies in the domestic segment are indicated by the large amount of excess capacity in the domestic air transport market. For instance, the total number of seats offered by Indian Airlines and private airlines is roughly 50,000 a day whereas actual domestic traffic per day is not more than 36,000. These figures indicate a healthy ratio of seat utilisation of 72% but they do not tell the entire picture. If we look at the Peak Load Factor in the peak tourist season then we One of the serious concerns to the Ministry of Civil Aviation is that the operating costs of flying in India are as high as 86% of total cost. The Ministry wants to bring down such costs to 65%.

Similarly, the statistics for Air India reflect the lack of competitiveness in international operations.³ During the fiscal year 1997/98, while Air India had total revenue of Rs. 4,088 crores, its net losses were substantial at Rs. 181 crores, reflecting the airline's weak financial position. AI's aircraft utilization is very low at 7.44 hours per day per aircraft as opposed to utilization rates of over 10 for airlines such as Singapore Airlines and KLM. Its passenger load factor is only 67.5 percent. The airline also suffers from tremendous overstaffing with a staff of 18,751 relative to a small fleet of 26 aircraft. Hence, productivity levels are very low at 720 workers per aircraft. Another indication of AI's poor performance is the fact that unlike more efficient national carriers, Air India carries less than 25 percent of the domestic passenger traffic.

³ This is notwithstanding the fact that AI has several advantages, including a large home market base, India' tourism potential of India, unused rights available under the bilaterals, low labour cost, availability of in house experts in managerial and technical areas, and a long association in major international markets.

There is also a problem of surplus capacity in international operations with capacity entitlements far exceeding traffic needs (discussed in detail in the section on air service agreements). Surplus capacity is in part a result of the low utilization rates and productivity levels. It is responsible for a decline in gross yields for important international markets in recent years. The latter has made AI's operations less economic. The drop in gross yields in some markets is shown below.

One-way gross yields

	1992/93	1997/98	% Var.
	-----	-----	-----
India-NYC vv	USD 617	USD 580	(-) 6.0
India-LON vv	USD 357	USD 343	(-) 3.9
India-FRA vv	USD 416	USD 309	(-) 25.7
India-Gulf vv	USD 276	USD 254	(-) 8.0
India-NBO vv	USD 245	USD 301	22.9
India-TYO vv	USD 504	USD 480	(-) 4.8
India-SIN vv	USD 212	USD 257	21.2
Exchg. Rate : USD 1 =	Rs.30.212	= Rs.36.404	

Thus, overall, the scenario for international air transport operations by India is very bleak at present. It is marked by lack of sufficient funds for modernization and expansion, low productivity, low fleet base, a bloated workforce, a limited international network, and unremunerative yields. Given the carrier's weak position, rapid liberalization in the air transport services industry poses challenges for India's airlines.

India's trade in air transport services

There are difficulties in assessing the magnitude of exports and imports in air transport services due to problems in defining and valuing trade in this sector and the lack of information in this regard. However, one can get an idea of the magnitude of trade in this sector from the volume of traffic. In 1997, total international passenger traffic to and from India was 10.8 million of which Air India carried 2.3 million or 21 percent, Indian Airlines carried 1.1 million or 10 percent, and foreign airlines carried 7.4 million or 69 percent. Since only Air India and Indian airlines have been designated by the government to operate international air services to or from India under various bilaterals, these are the only major domestic service providers in terms of exports. Although no detailed valuation of trade under the four GATS modes of supply is available for the Indian air transport services sector, from Air India's perspective, cross border supply forms the core of its operations.

On the whole, India is a small player in the international market. Its export possibilities in this sector are at present quite limited due to unutilized capacity relative to traffic requirements and infrastructural constraints. In particular, in all three areas within this sector that are covered by GATS, India is not an important player.

In the sub sector of Computer Reservation System India is a net importer. There are four main CRS companies in India of which Amadeus and Galileo together cover 80 percent of the market. The CRS system available in India is at an elementary level. It mainly covers the first part of the travel cycle in which information required for booking is collated and transferred. In order to be more efficient in this sub sector, CRS

networks have to be more sophisticated requiring a transition to Basic Settlement Plan (BSP) in which a centralised banking system acts as a mediator between airlines and agents.

In the sub sector of 'maintenance and repair of aircraft', safety and maintenance standards are laid down by aircraft makers and the DGCA. While India has the potential to export services in this area, at present it is not an important player in the market for repair and maintenance services. The private airlines in India get their fleet maintained abroad, although they could reduce their costs by 20 percent by maintaining their fleet in India.⁴ Similarly, in the sub sector of sales and marketing, India does not have much of a presence in the international market.

Air Service Agreements

India has been following the bilateral system of negotiations of Air Services agreements (ASAs). It has progressively expanded the scope for air transport services by increasing the number of ASAs with other countries, from 19 in the 1970s to 95 at present, thereby increasing the possibilities for direct air links to/from India. Some important features of these ASAs include:

- Pre-determination of capacity in all cases except with the USA. The general principle followed is alignment of capacity to 3rd/4th freedom traffic requirements.
- Regulation of market access through specific exchange of points of call. In India these are limited to the 5 "international" airports, viz. BOM, DEL, MAA, CCU and TRV. Some neighbouring countries have been granted wider access.⁵
- Inclusion of "reciprocity" and "fair and equal opportunity" principles in all bilaterals.
- Provision of safeguards through designation criteria, capacity control and system of fare approvals.
- Transparency via registration of the ASAs with ICAO and codification and publication of the same. However, substantive matters relating to exchange of entitlements and traffic rights are done through side agreements, which are treated as confidential.
- Dispute settlement mechanism through a process of bilateral consultations, failing which, through arbitration.⁶

⁴ Common maintenance problems are component fatigue, which leads to structural breakdown of aircraft and airframe corrosion, which lead to structural failures. Periodical checking and maintenance of black box is also important.

⁵ Market access for foreign carriers in India in the core areas of cross border supply is regulated by granting of rights to foreign carriers to uplift or discharge traffic at specific points of call. This permission is currently limited to the five international airports, viz. Mumbai, Delhi, Calcutta, Chennai, and Trivandrum. Airlines of some neighbouring countries have been granted wider access (e.g., Bangalore, Patna, Lucknow, and Varanasi for Royal Nepal Airlines). The access to these points varies from bilateral to bilateral. In new ASAs the policy is to grant one point of call out of Mumbai or Delhi.

⁶ Most of the ASAs provide that if any disputes arise due to the interpretation or application of the agreement, then the Aeronautical Authorities would endeavour to settle it through

The bilateral ASAs signed by India generally ensure that foreign carriers are reciprocally allowed non discriminatory treatment in areas such as fuel pricing, airport/route navigation charges, slots, sales and marketing facilities, etc. However, there is discrimination between national and foreign carriers under these ASAs with regard to market access within the country. While domestic carriers are given market access to all points in India, the foreign carriers can only operate to and from designated points in India.

India currently follows a policy of dual designation to cover Air India and Indian Airlines. It has 22 ASAs with multiple designation, 35 ASAs with single designation, and 36 ASAs with dual designation. The designation criterion of Substantial Ownership and Effective Control is primarily used, though in some special cases, India also accepts Principal Place of Business as the designation criteria. There are 91 ASAs under the former designation criteria and 2 under the latter.

With regard to tariff approval, India predominantly uses a combination of double approval and single disapproval (which is less restrictive since it does not require approval in writing). In some recent cases, country of origin approval has been accepted. India has, however, not yet accepted the most liberal system, i.e., double disapproval. At present, there are 26 ASAs with double approval, 62 ASAs with single approval, and 3 ASAs with country of origin approval.⁷

Under the ASAs, major carriers have access to all four, or at least three major Indian gateways. In the new ASAs, the policy is to exchange 1 point of call, Bombay or Delhi, and to encourage services to Calcutta, sometimes with co-terminal rights behind Bombay/Delhi/Madras. There are 39 ASAs with single point of call in India, 29 ASAs with two points of call, and 26 ASAs with multiple points of call in the country.

The emphasis today on point-to-point services under the ASAs in contrast to the earlier ASAs, which widely exchanged fifth freedom, rights due to range limitations of aircraft then in service. Exchange of fifth freedom rights is not much encouraged in the more recent ASAs. At present there are 46 ASAs with intermediate 5th freedom rights and 39 ASAs with beyond 5th freedom rights. Routing flexibility without 5th freedom rights has been consistently exchanged in almost all recent ASAs and is provided under 41 of India's ASAs.

India has 55 ASAs with commercial agreement for unilateral operations and for additional entitlements/rights exchanged and 12 ASAs with cooperative service

negotiations failing which it would be referred to the governments for settlement. In some agreements, there is further provision to refer disputes to a three member arbitration tribunal whose decisions will be taken as binding. However, the need to resort to arbitration to settle disputes has not yet arisen for India under the various bilaterals.

⁴ There are four possible forms of tariff approval as laid down in the ASAs. These are:

(i) Double approval where a tariff only comes into force after it has been approved by the Aeronautical Authorities of both the countries; (ii) Single disapproval where a tariff will not come into force if it has been disapproved by even one of the two Aeronautical Authorities involved; (iii) Double disapproval where a tariff will not come into force unless it has been disapproved by both the Aeronautical Authorities; and (iv) Country of origin where a tariff will come into force only after it has been approved by the Aeronautical Authority of the country in which the journey originates.

arrangements. As regards code sharing, including with 3rd country carriers, increasingly, the latter are being exchanged on a case-to-case basis. There are 23 ASAs with code sharing with 3rd/4th airlines and 8 ASAs with code sharing with third parties.

India has a bilateral with the US. This is the most liberal bilateral agreement that India has. Under this bilateral, there are no limits on capacity that can be operated by designated airlines of the two sides or on the number of airlines that can be designated. Although the points that can be touched in each other's territories are specifically designated there is wide flexibility in the intermediate and beyond points through which the services can be routed. Both sides can operate code share services with third country airlines and also touch two points in the other's territory on the same flight without cabotage rights. However, there are certain restrictions that have been placed on Air India's fifth freedom rights between London and certain designated points in the US. In spite of such favourable bilaterals one puzzling fact is the pulling out of the United Airlines out of the country. It is understood that the "commercial terms" in relation to code sharing and capacities permitted, east bound, were reasons for this airline pulling out.

The ASAs have met India's needs and interests well thus far. This is evident from the data on entitlements, traffic, and capacity provided below.

Increase in entitlements, capacity, and traffic

	1992 -----	1997 -----	AAG -----
Total Entitlements	22.030 Mill	30.920 Mill	7.0%
Seats operated	10.579 Mill	14.729 Mill	6.9%
Pax traffic	7.493 Mill	10.786 Mill	7.6%

All the above three parameters have grown in tandem at around 7 percent to 7.5 percent.

A comparison of projected traffic needs relative to existing capacity entitlements indicates that the ASAs have adequately met India's needs. For instance, at an estimated rate of growth of 7 percent per year in pax traffic, the required number of seats would be 17.461 million as against available capacity entitlement of 31.94 million seats at the end 1998. This means that the entitlements available are 80 percent more than the seats required. However, as has been stated below a number of bilaterals have been entered into out of political consideration and are likely to remain unused. There are two important factors that need to be taken into account for aviation purposes. The first is the importance of each individual city pair, the second is the seasonality factor, bilaterals should be examined in this light and not aggregated. Therefore, aggregate demand supply position may not reflect the availability position correctly.

The increases in entitlements and capacity operated have also been adequate to meet tourist demands. For instance, tourist arrivals into India, including nationals of Pakistan and Bangladesh, increased from 1.868 Million in 1992 to 2.374 Million in 1997, i.e. at an average rate of 4.8 percent per annum. But this growth rate was lower than the increase in entitlements and capacity operated during this period. It needs to be noted, however, that part of the excess capacity is due to a significant number of bilaterals (44 out of the existing 95 bilaterals) that remain unutilized on both sides, in part because they were concluded more for political compulsions than for economic reasons. Hence, some amount of capacity is likely to remain unutilised due to inadequate traffic.

From the perspective of the tourism industry the story looks different. The tourism industry is of the view that there is an acute shortage of seat capacity. An indicator of insufficient seat capacity is load factors. It is commonly accepted in the aviation sector that load factors in the region of 75-80% imply a capacity constraint. The table below gives the month by month average seat capacity during Oct 98-Sept 99 period.

SELECTED AIRLINES LOAD FACTORS FLYING OUT OF MUMBAI

Airline	Source Market	Load Factor	Flights / Week	Period
North West	New York	77%	4	(Oct'98 - Sept'99)
British Airways	London	75%	7	(Oct'98 - Sept'99)
KLM	Amsterdam	84%	3	(Oct'98 - Sept'99)
Lufthansa	Frankfurt	93%	5	(Apr'98 - Mar'99)
Swiss Air	Zurich	70%	6	(Apr'98 - Mar'99)
Cathay Pacific	Hong Kong	73%	7	(Oct'98 - Sept'99)
Singapore	Singapore	89%	7	(Oct'98 - Sept'99)

Source - M&A surveys

These figures indicate an acute shortage of seats in the peak tourist season. At that time both domestic as well as international passengers face great difficulty in obtaining seats for their desired destination both within and outside India.

Thus, while the aviation industry claims that the existing system of bilateral agreements and open skies policy has enabled India to progressively liberalize its civil aviation policies and adequately meet the country's traffic and tourism needs, the tourism industry is of the view that there is an existing capacity constraint, which becomes increasingly severe in the peak season.

The opportunities available under these agreements, particularly with regard to the core areas of capacity and traffic rights vary from country to country, and the bilateral system has allowed India the flexibility to be as liberal or as restrictive as it wants but on a country to country basis depending on its needs and priorities.

Recent trends and developments indicate that there is considerable interest in foreign carriers to increase their operating opportunities to India. A number of major carriers are keen to enter into commercial tie-ups with Air India as a conduit for obtaining enhanced access to India. There are also a host of smaller countries that are interested in concluding new air services agreements with India.

A sector that is invariably linked with aviation industry is the tourism industry. Therefore ideally there should be an integrated strategy that can maximise benefits to both civil aviation and tourism. In India the biggest single challenge in developing travel & tourism, is of maximising air transport opportunities. Most international business travellers as well as a significant and growing number of leisure travellers arrive by air – particularly from major tourism origin markets. It is estimated that 98.4% of foreign tourists arrived in India by air. In this regard a model has been developed which looks at the costs and benefits of an annual increase of 1 million visitors per annum, which is a reasonable target to assume over a medium term.

In order to achieve a incremental level of 1 million visitors per year, the tourism industry will need to make an investment of approximately Rs. 5,400 crores in hotel & related facilities for the construction of additional 18,000 rooms needed to cater to these additional visitors; whereas the Air India would need, (assuming that Air India would like to retain a 50% share of this traffic) an amount of Rs. 10,500 crores for purchase of aircraft.

It may be noted that the capital expenditure by the hotel & tourism industry would have a import component that would be as low as 5 to 10%, whereas capital expenditure required for the creation of additional airline capacity, either by way of purchase or lease, would almost entirely flow to the benefit of Airbus Industries in Europe or Boeing in Seattle. Even the financing of such acquisition would be in foreign exchange with its attendant currency risk exposure. The capital expenditure made by the tourism industry has far greater positive repercussions on Indian industry than airline expenditure for aircraft.

Foreign exchange revenue earnings of the tourism industry and Air India have been calculated in the model. Based on fairly conservative assumptions, it may reasonably be assumed that an additional 1 million visitors would generate a total revenue (excluding imports required to earn such revenues) of over Rs. 4,300 crores, whereas Air India, to service 50% of this business, would earn just under Rs. 2,000 crores (net of imports).

Looking from the employment point of view, an additional 1 million visitors would create over 150,000 jobs in the tourism industry and 6,300 jobs in Air India.

AIRCRAFT REQUIRED FOR ADDITIONAL 1 MILLION TOURISTS		
Annual round trips per aircraft		
Average distance from markets		8,000 km
Average round trip time		17 Hours
Annual aircraft utilisation		4,500 Hours
Annual round trips per aircraft		265 Round Trips
Aircraft Carrying Capacity		
Seats per aircraft	5	400 Seats / A'craft
Average load factor	6	65% Load
Passengers per aircraft		260 Pax / A'craft
Proportion of Foreign Visitors	7	50% Proportion
Aircraft Required		29.06
	say	29 Aircraft
Investment per aircraft	5	752.5 Rs. Crores
Total investment or lease capital value		21,823 Rs. Crores
Assuming Air India retains just under 50% of Capacity		10,535 Rs. Crores
		14 747's
EMPLOYMENT GENERATED BY THESE AIRCRAFT		
Air india average per aircraft		720 Persons
World average per aircraft (including outsourcing)		250 Persons
Average assumed for the purpose of this model		450 Persons
Total Employment generated		6,300 Persons

Here it has been assumed that acquisition by lease or purchase of 747 aircraft with an average seat capacity of approximately 400 passengers. Such aircraft are presently said to be valued in the region of US\$ 150 million (Rs. 752 crores).

Average load factors for popular traffic routes range from 75 to 95%, however with a substantial increase in airline capacity, as assumed by this model, it is reasonable to assume that load factors will drop to world averages which are in the region of 65%.

At present based on total international traffic handled at all Indian airports, the ratio of foreign visitors is 37% with 63% of arrivals and departures being made up of Indian passengers. With this increase in capacity it has been assumed that this ratio will alter to 50% foreign visitors and 50% Indian travelers for the incremental capacity.

EARNINGS FROM TOURISM & AVIATION FROM ADDITIONAL 1 MILLION VISITORS		
Visitor Spending		
Number of additional visitors		1,000,000 Visitors
Spend per visit (Presently \$1,300)	8	1,100 US\$
Import Leakage	9	10% Proportion
FX Earnings		990 US\$ Millions
FX Earnings		4,356 Rs. Crores
Air India Revenue		
Number of additional visitors		500,000 Visitors
Average Km per pax		16,000 Km per pax
Average Rate per Km	10	0.10 US\$
Import Leakage	9	45% Proportion
FX Earnings		440 US\$ Millions
FX Earnings		1,936 Rs. Crores
Ratio of Tourism FX Revenue Vs. Airline FX Revenue		2.25
Summarised Costs & Benefits		
	Tourism Industry	Air India
Capital Expenditure	4,516	10,535 Rs. Crores
FX Revenue Net of Imports per annum	4,356	1,936 Rs. Crores
Ratio of annual net FX Revenue to Capital	0.96	0.18 Ratio
Employment	150,534	6,300 Persons

In measuring the benefit to the economy it is necessary to deduct the cost of imports. Based on studies conducted worldwide and taking into account that India is a large country and not an island economy like the Maldives, Mauritius or Seychelles, it is estimated that no more than 10% of visitors' spending is in relation to imported items. In the case of airlines the proportion of import leakage is considerably higher by way of loan repayments, purchase of spare parts and foreign exchange expenditure that needs

to be incurred. Estimates range from 40 to 50% on a worldwide basis and here an import leakage factor of 45% has been assumed.

The average rate per passenger kilometer has been assumed at \$ 0.10 per passenger kilometer. The fares between Mumbai and some of the major source markets have been compiled and this average comes to 11.28 per passenger kilometer for the lowest excursion fares. The average including business and first class fares (even though smaller volumes) would be higher. However, the passenger kilometer rates compiled would lower the average considerably. The international norm of 10 per passenger kilometer is therefore appropriate.

2: Domestic and External Constraints to Air Transport Service Exports

As noted in the preceding section, the Indian aviation industry has a marginal role in the world market and is inefficient compared to many of the big players. The main national carrier suffers from persistent losses and is threatened by the prospect of liberalization. The domestic segment is also plagued by problems of inefficiency and low capacity utilization. This section outlines the main domestic and external constraints contributing to the weak performance of India's air transport services sector. These include regulatory, structural, and financial constraints.

2.1 Domestic constraints

One major constraint to improving Air India's position is the lack of funds. Today, Air India is suffering huge losses and is unable to compete with most of the international airlines. It has given up most of its lucrative routes and its major destinations today are now in the Middle-East where it does not face as much competition from the large European and American airlines. To overcome this situation Air India is in dire need of funds. However, the government is not in a position to provide such funds. The only other alternative is for a foreign airline to form an alliance with Air India. The Disinvestment Commission has recommended the privatization of Air India with major injection of funds by a strategic partner. However, none of the major players are willing to form an alliance with an uncompetitive partner such as AI. Hence, the carrier is caught in a vicious circle of losses and continued poor performance. The prospects are quite bleak. This is a classic chicken and egg situation.

The Government has set up a time frame of one year to disinvest the two state owned carriers--Indian Airlines and Air India. Financial restructuring of Indian Airlines will be carried along the lines suggested by Kelkar Committee. The Government has recently approved equity infusion as well as restructuring of Indian Airlines. The Ministry of Civil Aviation has already conveyed the decision of the Government to: -

- i) the release of Rs. 325 crores as equity injection to Indian Airlines and
- ii) permit Indian Airlines to mobilise funds from the Capital Market through Initial Public Offering (IPO) or any other modalities available for restructuring.

Air India's disinvestment will be along the lines suggested by Disinvestment Commission. In the Eighth report submitted to the Government, the Commission has recommended that disinvestment of Air India should be according to the following steps. Initially, the government should provide Rs 1000 crores immediately as equity for financial restructuring of Air India. This would raise AI's share capital to Rs 1154 crores. Simultaneously, it should initiate a process of inducting a strategic partner on the basis

of globally competitive bids by issuing fresh equity shares with a face value of Rs 770 crore, thereby reducing the government's holding to 60%. The government should thereafter disinvest 20% of the total paid up capital by offering 10% to the domestic institutional investors at the price paid by the highest bidder for AI's shares and the remaining 10% to retail investors and employees at a discount.

There are major regulatory impediments to the divestment of AI. The current national policy debars foreign airlines or their subsidiaries from directly or indirectly holding a stake in domestic carriers. The latter is despite the available international experience, which shows that equity in an airline is in most cases picked up by another airline. If the recommendation by the Disinvestment Commission is to be accepted by the Government, then the current national policy applicable to domestic carriers cannot be made applicable to Air India.

Air India and Indian Airlines, being typical PSUs are subject to various governmental regulations and to the usual consequences of such controls. The process of enforcing accountability of public sector enterprises (PSUs) to the Parliament and the setting up of various Parliamentary Committees to examine their activities have major ramifications for the management of these airlines. It slows down the decision making process. The opportunity cost of meeting the government's accountability and control requirements are very high. Moreover, since the overriding emphasis is on taking a fool proof decision that does not require any subsequent investigation, the management is tempted to take decisions that are as risk free as possible. Such an approach adversely affects the airlines' efficiency and competitiveness.

The mandate of serving as a public sector undertaking has forced additional burdens upon the airlines. For instance, one major objective has been to provide adequate employment opportunities without consideration to economic and financial concerns. As a result, over the years, Air India has become grossly over staffed. Today, it is burdened with a staff over 18,500. The productivity level of AI's staff is very low at 720 employees per aircraft compared to an international average of 200 to 250 workers per aircraft. AI needs to either shed its workforce or to expand its fleet to raise productivity levels. However, the latter options are constrained by political and economic compulsions, respectively. In particular, cutting the size of the workforce has proved very difficult as AI has been saddled with court cases for failure to retain contractual workers. Therefore, without changes in labour legislation and a liberal exit policy, it will be difficult for Air India to cut costs and raise productivity to internationally acceptable levels.

2.2 External Constraints

There are also several obstacles in the international market. One major problem is that Air India does not have access to adequate slots in most of the international airports. The available slots are not only fewer than required but also not commercially viable. In many cases the slots provided to AI at important international airports involve long waiting periods to catch connecting flights making the carrier less competitive and attractive relative to other airlines.

Air India has faced major slot problems at Tokyo Narita and London Heathrow, as well as at Chicago, Frankfurt and Seoul. At Narita, Air India is restricted to a maximum of 8 slots in the bilateral itself which caps Air India at 4 turn-arounds or 2 transits per week even though Air India has the rights to operate upto 14 services with A310 type of aircraft. At London Heathrow, Air India is unable to obtain slots to operate additional Trans Atlantic transit flights even though it has entitlements to operate 2 more transit services. It needs to be noted that foreign carriers have not faced major difficulties in

obtaining slots in India. The problem of slots is related to infrastructural constraints in major international airports in the form of runway and terminal capacity. Such bottlenecks prevent smaller and weaker carriers such as AI from fully utilizing their capacity entitlements.⁸

Nowadays, airlines and authorities are increasingly recognising that slots are valuable “commodities” which can be traded. In the US, airlines are allowed to sell their slots for cash. The EU has so far been opposed to slots being sold and its position was that any slots released would go into a “pool” for reallocation. However, a recent Court decision in UK has upheld the right of an airline (Air UK) to sell its slots. If selling of slots becomes an established practice, it would seriously disadvantage the financially weaker airlines seeking new slots, and developing countries would then need to seek immunity for their airlines from such payments. There is, however, need to look at the issue from a wider perspective. From the view point of tourism sector India may greatly benefit if strict bilateralism advocated by Air India was to be replaced by a more dynamic approach to this management of slots.

Anti-trust and immunity related regulations in developed countries such as the US pose another barrier for AI. While US anti-trust regulations are meant to stimulate competition and protect consumer’s interests, in actual practice, immunity is granted in select cases where it meets US national priorities or confers an advantage to US airlines. For instance, anti-trust immunity granted to Northwest-KLM & Lufthansa-United to obtain bilateral benefits from negotiations with Netherlands and Germany, have given these airlines tremendous marketing advantages over their competitors. In addition, the granting of such immunity to the strong and large carriers puts airlines such as AI at a major disadvantage in case of alliances with unequal partners such as United. AI needs immunity from the application of such anti-trust laws.

Another constraint concerns the application of domestic competition policies to airline routes, limiting the scope of commercial agreements used as safeguards in the existing bilateral framework. For instance, the European Union (EU) is considering application of its competition rules on non-intra EU routes. This would enable them to scrutinise and vet interairline agreements. In this eventuality, Air India could be precluded from entering into, expanding, or improving the terms of commercial agreements with EU carriers.

The central issue here is that the airlines of developing countries like India would need immunity from the application of such policies. For example, the Indian carriers should be permitted to discuss market fares with any US carrier with whom they have a code share relationship since the seat prices - the most crucial element from the point of view of profitability - under such a code share would inevitably be linked to the market fares. Similarly, EU’s competition policy should not preclude the Indian carriers from entering into or expanding the scope of its commercial agreements.

AI’s potential for trade in air transport services is also constrained by problems with technical certification in important developed country markets, such as the US, Japan, and the EU. Although Air India has the potential to carry out major engineering, maintenance and overhaul work of other airlines and to provide technical assistance and training on aircraft and engines, its engineering department does not have the

⁸ In this case India should retain the option to take reciprocal action against a country which has not made slots available to the Indian carriers to enable them to use entitlements exchanged bilaterally.

approval from the FAA or CAA or JAA to do such work in the US, Canada, and Japan. This is despite the fact that it has the approval of DGCA India which has been assigned category 1 rating by the FAA, indicating excellent regulatory controls. The granting of approval by these overseas aviation authorities would enhance AI's opportunities in attracting overseas maintenance and overhaul work. The lack of such approval acts as a barrier since most potential customers require the overhaul agencies to have FAA/CAA/JAA approval.

Both FAA and JAA require the organisation seeking certification to be approved as FAA or JAA repair station, to produce proof in the form of a "Letter of Intended Use" by a US or a European certificated Airline, that the Airline requires maintenance support at a foreign location.⁹

Another external constraint is unfair competition in regard to liability for death/injury of passengers. The developed countries have a variety of legislation in this regard, which adversely affects the position of airlines like Air India, which follow a different liability regime. The EU, for instance, has enacted a legislation under which all EU carriers must subscribe to unlimited fault based liability for death/injury with strict liability (i.e. irrespective of whether the carrier is at fault or not and without any defense) for claims upto SDR 100,000. AI is required to clearly inform passengers that it does not subscribe to this liability regime. Such a requirement places carriers like Air India at a distinct disadvantage, as they have to advertise a feature that they do not have.

Various environmental regulations like those related to noise and fuel emission also handicap weak airlines such as Air India. Such regulations are promoted by the developed countries, which not only manufacture the aircraft but also have airlines that are financially sound enough to afford the associated costs. Smaller airlines like AI that are financially weak are unable to afford the cost of meeting environmental regulations.

Though the industry has already set up a set of rules relating to noise, emissions etc, some times attempts of certain countries to apply stricter standards can place additional burden on the aircraft of the developing countries. Recently EU had made an attempt to apply stricter standards regarding hushkitted engines which ran into trouble as US was strongly against it for it still has a very large fleet of hushkitted aircraft. Unilateral actions such as that of the EU raise the need for immunity for airlines of developing countries from application of stricter norms, which place undue financial burden on them.

Finally, foreign exchange restrictions with regard to repatriation of funds have acted as a disincentive to establishing and expanding AI's operations in some countries. The main issue here is that the airlines should be free to repatriate their surplus funds out of a country in any convertible currency, and India has consistently provided for this in its Air Services Agreements.

3. GATS and Air Transport Services

⁹ At present, Air India's ability to take up outside work is restricted due to a peak in its workload. This is due to several mandatory modifications and aging aircraft modifications. Hence, Air India will not be able to demonstrate to FAA at this time that it has intended users for its maintenance. Whenever, the workload slackens, Air India is bound to take up outside party work. Air India is confident of its maintenance system and is assured that it will be able to get approval from FAA whenever it desires.

The preceding sections have noted that liberalization in air transport services has taken place through a system of bilateral agreements within the multilateral framework of ICAO and IATA. Most countries have been very opposed to making core issues in this sector subject to multilateral liberalization. A previous attempt to realize a multilateral agreement failed at the Chicago conference and to date there are only 12 signatories to the International Agreement on Air Transport Services. Most countries, including the most important players in the world air transport market, such as the US and the EU want to continue with the present system.

It is therefore not surprising that the scope of GATS is limited in the case of air transport services. At present, only three sub sectors within air transport services are covered by GATS while core issues have been carved out of the scope of GATS. This section outlines these areas that are covered by GATS. It also discusses the nature and significance of the commitments made in this sector.

3.1 Areas covered by GATS

Air transport services are covered only to a limited extent by the GATS. These include, aircraft repair and maintenance service, selling and marketing of air transport services, and computer reservation services. GATS does not apply to all the measures that affect traffic rights or services directly related to the exercise of traffic rights. Moreover, even in the included areas, any specific obligation or commitment assumed is not at the expense of Member's obligations under a bilateral or a multilateral agreement that is in effect on the date of entry into force of the WTO Agreement.

Aircraft Repair and Maintenance Services

Aircraft Repair and Maintenance activities are defined as services that are undertaken on an aircraft or a part thereof while it is withdrawn from service. They do not include line maintenance. This definition roughly corresponds to what is known in the sector as MRO (Maintenance, Repair, and Overhaul). The MRO market was valued between \$23-28.5 billion in 1996 and is expected to rise to \$33 billion by 2005.

Among the four modes of delivery under GATS, consumption abroad and commercial presence are the most important in this subsector. The presence or absence of restrictions on consumption abroad of air maintenance services is critical. For example, until 1998, the US Federal Aviation Administration allowed foreign repair of American aircraft only in emergencies but these rules were liberalised in 1998. As a result, there was a 150 percent increase in the number of foreign repair stations. In a similar way, commercial presence conditions affect the establishment of foreign maintenance facilities in third markets.

Computer Reservation System

Computer Reservation System is defined as services provided by computerised systems that contain information about the carriers' schedules, fares, and fare rules for which reservations can be made or tickets can be issued. During the late 70s, airlines began to develop computer reservation systems to provide display of schedules, space availability, and tariffs. Today, CRSs along with electronic ticketing and use of Internet has become a critical competitive tool for airlines. However, the system is subject to abuse, which has led governments to adopt regulations or codes of conduct to ensure

fair competition.¹⁰ Rules have been introduced by the ICAO Canada, European Union, European Civil Aviation Conference, and the United States to take care of uncompetitive practices.

Successive revisions of various codes have taken account of the GATS. For instance, the 1996 revision to the ICAO CRS Code of Conduct seeks to minimise any possible conflict between the obligation of the states that are parties to the GATS while also encouraging them to follow the ICAO Code of Conduct.

Selling and Marketing of Air Transport Services

This service pertains to opportunities for the air carrier concerned to freely sell and market its air transport services, including all aspects of marketing such as market research, advertising and distribution. This definition is restricted to selling and marketing activities undertaken by the airline company itself, and does not cover these activities when they are carried out by CRS suppliers and travel agents. Since nothing is said about to whom the sales are made, it covers not only direct sales to private or business clients but also block sales of seats to travel agencies and tour operators. Also, since there is no distinction between passenger and freight, it includes not only sale of passenger tickets but also sale of airfreight by means of bills of lading.

Direct sales of tickets on regular flights by airline companies account for 20 to 30 percent of all tickets sold. The size of the market can be determined by the value of operational expenses for "ticketing, sales and promotion". This was \$37.5 billion in 1994 and \$40 billion in 1995

3.2 Areas excluded from GATS

The Annex on Air Transport specifically excludes traffic rights and services directly related to the exercise of traffic rights. Two core areas in civil aviation, capacity entitlements and market access (traffic rights) from which the economic benefits of air transport really flow, are at present excluded from GATS. However, GATS provides for the Council for Trade in Services to periodically review developments in air transport sector with a view towards including other activities.

3.3 Discussion of commitments

(i) Aircraft repair and maintenance services

In this sub sector, 32 members (counting the EU as one) or 34 percent of all members have made commitments on market access and national treatment. This is an unusually high number for a transport activity. Of these, 24 countries including the EU and the US have opted for no limitations on market access under consumption abroad, the principal mode of supply in this sub sector. Among the important countries, only Canada and Switzerland have not bound this sector for reasons of technical infeasibility. In the case of national treatment of consumption abroad, only Switzerland and Nicaragua have declared this mode to be infeasible and therefore unbound.

¹⁰ So long as CRSs were owned by major airlines, they were viewed as an element of airline distribution system that could be used to favour the owner, mainly because displays could be biased to give more prominent display to the services of the CRS owners in preference to those of other carriers. Such practices were deemed uncompetitive and governments introduced rules to rectify the situation.

As regards commercial presence, the other mode of supply relevant to this sub sector of air transport services, several countries have filed commitments with limitations under market access. These limitations include demands for a corporate seat in the host country (Czech and Slovak Republics), proper authorization from the civil aviation authorities or the Ministry of Transport of the host country (Turkey, Romania, and El Salvador), and limits on the number of licenses conferred to foreign service providers in this area. Likewise, in the case of national treatment, commitments are subject to limitations (e.g., requirement of a corporate seat in the host country) for commercial presence. Also, some countries (Switzerland) have linked commitments in mode 4, movement of natural persons, to commercial presence in the country.

(ii) Selling and marketing of air transport services

In this sub sector, 21 members (again counting the EU as one) have made commitments. The commitments are, however, less liberal than in the case of repair and maintenance services. With regard to the two most important modes of supply in this sub sector, namely, commercial presence and movement of natural persons, a large number of commitments are either subject to limitations or unbound. For market access relating to commercial presence, only 13 countries have opted for no limitations while 10 countries including important markets such as the US and Canada have declared this mode of supply not applicable.¹¹ For market access relating to the movement of natural persons, 15 countries have left this mode unbound except as indicated in their horizontal commitments.

(iii) Computer Reservation Systems

In this sub sector, 26 members (counting the EU as one), or 29.5 percent of all WTO members have made commitments. This is again a relatively high number for a transport activity. The commitments are quite liberal. For the two most important modes of supply for CRS, namely, cross border supply and commercial presence, most countries, including important ones such as Canada, EU, Australia, and New Zealand have filed with no limitations for market access. The US, however, has declared these modes to be not applicable and has filed for a MFN exemption.¹² With regard to national treatment for CRS, most European Union countries have made cross border supply and commercial presence unbound "for obligations of parent and participating carriers in respect of a CRS controlled by an air carrier of one or more third countries". Most countries have filed without limitations on national treatment or have subjected them to their horizontal commitments. Most of the limitations and exemptions filed for CRSs are based on the more detailed bilateral and multilateral arrangements on codes of conduct that already govern these activities.

A significant proportion of the countries that have filed commitments in air transport services have also filed for MFN exemptions in one or more of the three covered sub sectors. Most of the Article II exemptions have been filed for CRS and sales and marketing. The following table shows the status of MFN exemptions in this sector.

¹¹ For instance, Turkey has allowed foreign airlines to sell tickets subject to the obligation that they open sales offices in Turkey and Philippines has agreed to make commitments for cross border supply subject to commercial presence.

¹² An example of a limitation on market access is that of the Republic of Korea which has made commitments in cross border supply but has allowed access only through publicly switched networks.

Article II Exemption to the GATS Annex on Air Transport

Party	Repair and maintenance	M	Selling and Marketing	Computer Reservation System
Austria	✓		✓	✓
Canada			✓	
EC and its Member States			✓	✓
Finland			✓	✓
Iceland			✓	✓
Kuwait	✓		✓	✓
Liechtenstein			✓	✓
Norway			✓	✓
Poland			✓	✓
Romania			✓	✓
Singapore				
Sweden			✓	✓
Switzerland			✓	✓
Thailand	✓		✓	✓
United States			✓	✓

Note: A check mark indicates the services to which an exemption is applicable

As shown by the table, even big players such as the US and the EU have filed for MFN exemptions in this sector, implying the continued application of the conditions in force under the existing bilateral agreements. The only two countries that have made commitments without filing for exemptions are Singapore and Netherlands, indicative of their stance on liberalization via GATS as opposed to the bilateral system. (More detailed discussion of bilateralism versus multilateralism is provided later in this paper).

India has not made commitments on market access or national treatment in any of the three included sub sectors. It has also not filed for any MFN exemptions in this sector.

3.4 Overall Significance of the Commitments

The overall significance of commitments made in air transport services under GATS thus far is very limited. This is due to three reasons. Firstly, the coverage of air transport services under GATS is very limited as core issues such as capacity entitlements and traffic rights have been explicitly carved out of the agreement.

Secondly, although the commitments filed in the covered sub sectors are on the whole liberal, the fact that many countries that have scheduled commitments have also made use of Article II exemptions, limits the effective liberalization that has been realized even in these three areas. For instance, it was noted earlier that barring countries such as Singapore and Netherlands, most countries have claimed MFN exemptions. This means that for countries filing MFN exemptions, regulations and conditions pertaining to their bilateral agreements will not only coexist with the GATS obligations but could potentially supersede the latter. The latter countries have retained the right to pursue liberalization on a bilateral basis while giving the appearance of liberalizing multilaterally. Thus, what has really emerged is a dual system of regulation in these three activities with some states applying GATS obligations to one or more of these services and other states continuing to abide by existing arrangements and agreements.

Finally, the commitments filed under GATS in air transport services have limited significance for India, as India has not made any commitments in this sector. This implies that there are really no structural or policy related implications emerging directly from GATS. Moreover, given that India is a marginal player in the global market and that its domestic air transport sector is highly uncompetitive and weak, it is not in a position to gain from liberalization in this sector by other countries. India does not have a comparative advantage in CRS or sales and marketing. While it has some potential to export air repair and maintenance services, the scope for expanding trade in the latter is limited by technical certification problems faced by India in important overseas markets. In short, for various reasons, India does not stand to benefit from the multilateral commitments made under GATS and in fact, may only stand to lose from further multilateral liberalization in this sector.

4. Strategy for Future Negotiations on Air Transport Services

This section outlines India's strategy with regard to further liberalization in air transport services under GATS. It discusses India's position on the three areas that are presently covered by GATS, on expanding the coverage of GATS in the air transport services sector, and on the relative importance of the bilateral as opposed to the multilateral framework of liberalization in this sector.

4.1 Position on the areas covered

Opening up the field of Computer Reservation System will not impact India significantly, as it is neither a major importer nor a major provider of CRS services. This is because CRSs have been conceived and set up by airlines as marketing tool and require considerable investment in manpower and equipment. India is not in a position to undertake such level of investments in setting up and exporting CRS services.

However, India stands to potentially gain from further liberalization in this subsector due to its substantial in-house potential in this area based on its strength in software development and maintenance. Air India, for instance, has expertise in the field of Unisys Standard Airline Systems (USAS) software development and maintenance, which can be used by UNISYS. It also has the latest USAS software in the areas of reservations, cargo and departure control systems, which can be used to host other carriers. Air India is already hosting a number of foreign carriers for departure control from Indian airports. There are foreign multi-nationals in the field of computer and telecom who are interested in providing hosted services from India to meet the growing market in South Asia and South East Asia. Air India can participate in projects like VIS (Virtual Integrator Suite) with UNISYS for hosting cargo services to the other airlines and for meeting freight formalities in the Asia Pacific region by providing hosting facilities to UNISYS in India itself. Therefore, further liberalization in CRS under GATS could help India exploit its potential in this subsector even though as things stand at present, India does not have a comparative advantage in this area. India should also file a commitment in this subsector.

In the case of Aircraft Repair and Maintenance services, India has the ability to compete in the world market. The national carrier Air India has the potential to carry out major engineering maintenance and overhaul work of other airlines and can also provide technical assistance and training on aircraft and engines. Air India already has a full fledged maintenance facility at Mumbai to carry out all maintenance activities for B742/743/744, A310 and A300B4 aircraft besides the avionics and accessories fitted on

these aircraft. It also has facilities for repair and overhaul of CF6-50C2/80C2, JT8D, JT9D-7J/7Q, and PW4056 engines.

Besides, Air India also has the capability to undertake aging aircraft modifications, avionics upgradation, corrosion prevention program, aircraft furnishings and reconfiguration, and other major modifications.

At present, Air India provides technical assistance and/or certification to a number of foreign carriers at various locations in India. These airlines include Kuwait Airways, Korean Air, Bellview Airlines, Kenya Airlines, Royal Nepal, Malaysia Airlines, Singapore Airlines, Saudia, Armenian, Royal Jordanian, Bangladesh Biman, KLM, Royal Brunei, Thai Airways and Gulf Air. Air India has earned Rs.6.8 crores in 1998/99 by marketing its resources in the Engineering Department. Air India has also planned to structure the Engineering Department as a separate profit centre and will be seeking to obtain more maintenance/ overhaul contracts in India from domestic and foreign operators. It is thus evident that Air India has the potential to undertake repair & maintenance activities.

However, there is not much of a prospect for Air India to set up major engineering facilities abroad in the near future. Hence, under the GATS, India should seek liberalization under "consumption abroad" for aircraft repair and maintenance services so as to enable foreign operators to freely obtain AI's services in India. India should also press for progressive liberalization under "commercial presence" to facilitate setting up engineering facilities in overseas markets and performing repair and maintenance services on-site. In turn, India should be prepared to make a commitment under mode 2. For commercial presence, India should consider making a partial commitment subject to conditions on foreign equity, local presence, etc. in view of the fact that allowing others to set up repair and maintenance facilities in India would erode its competitive edge due to low costs and available expertise.

To take full advantage of India's strength in this subsector, first there is need for approval from international organisations like FAA, JAA, and CAA for AI. Even though AI's engineering department has the approval of DGCA and has been granted category 1 rating by the FAA for excellent regulatory control, AI does not have technical certification from the international aviation authorities. Therefore, in addition to pushing for more liberal market access and national treatment commitments under modes 2 and 3 in this subsector, India should also negotiate for technical certification from one or more of the important aviation authorities overseas. It should make note of the high ranking received by the DGCA and ask for equivalence between approval granted by the DGCA and approval granted by the FAA, JAA, or CAA.

Indian Airlines has full fledged engineering facility and is able to do maintenance of aircraft owned by it. It has, however, not obtained FAA approval so far. Indian Airlines, however, fully meets DGCA certification requirements.

With regard to the third subsector covered by GATS under air transport services, namely, sales and marketing, India's stand is neutral. It does not have a comparative advantage, either present or potential in this area. Therefore, India would not be affected by more liberal commitments in this subsector or by maintaining the status quo. A feed back from the industry shows that there are fairly severe marketing restrictions that are dictated by the Memoranda of Understanding that are attached to bilateral agreements. Apparently a foreign airline is not allowed to advertise any destination other than the city pair being serviced ex India, for example Lufthansa may not advertise any other destination other than Frankfurt. Even though it is well known fact

that airlines like Lufthansa, British Airways and Delta with their networks have the greatest degree of network attraction, which they would like to advertise.

Another issue to consider is whether India should press for the removal of MFN exemptions. The position varies depending on the subsector in question. In the case of sales and marketing, India need not push for removal of MFN exemptions, partly it has no major interest in this subsector, and more importantly because it has bilateral Air Services Agreements (ASAs) with all the 15 countries who have filed for MFN exemptions, excluding 2 countries (Iceland and Liechtenstein). All these ASAs provide the requisite flexibility. Similarly, MFN exemptions in CRS do not hurt India, as it is not a major importer or service provider of these services. As regards aircraft repair and maintenance services, India should press for “consumption abroad” to be opened up while it should be restrictive and take MFN exemptions on “commercial presence”.

4.2 Expanding coverage of air transport services under GATS

There is some scope for expanding the coverage of air transport services under GATS. While there is consensus that sensitive areas such as capacity entitlements and traffic rights should remain outside GATS, there are two important areas which could be brought under the multilateral framework of GATS. These areas are code sharing and designation criteria.

Code sharing refers to the facility to code share between carriers of all signatory states. This facility could be multilaterally exchanged on 3rd, 4th and 5th freedom sectors subject to all the code sharing partners holding the necessary route, operational and traffic rights.

Designation criteria for international services at present requires designated airlines to be substantially owned and effectively controlled by the Government or the nationals of the country designating the airline. This effectively precludes the possibility of major cross border holdings even though it makes commercial sense for an airline of one state to make investments in the airline of another state. This issue could be multilaterally discussed under GATS and designation criteria could be more flexible, requiring instead that the place of incorporation and principal place of business be in the designating country. On this last issue, India has an interest because it is possible that in the near future, AI may not remain substantially owned and effectively controlled by the government or nationals given the restructuring and financial needs and constraints discussed earlier. India would not want to be in a position where AI would no longer be a designated airline for failure to meet the present criteria of ownership and control. Therefore, in its own interests, India should push for more liberal designation criteria, i.e. country of origin.

Here one should keep in mind that there is no inconsistency in the proposal to include Code Sharing and Designation Criteria under GATS while keeping out the core areas of capacity and traffic rights. For example, under the India/Madagascar bilateral, Air India can operate 2 services/400 seats per week between India and Antananarivo and Air Madagascar can similarly operate 2 services/400 seats between Madagascar and Mumbai, with only 3rd/4th freedom rights (i.e. 5th freedom rights cannot be exercised). The services must be operated by these two designated airlines only - and not through code sharing with a 3rd country airline - and these airlines have to be substantially owned and effectively controlled by their respective countries or nationals. Even though any changes in the capacity entitlements or traffic rights will continue to be negotiated bilaterally between India and Madagascar, by including CS and DC under GATS, the

following options would become available regarding **utilisation** of the capacity and the traffic rights that have been exchanged bilaterally:

- If there is a 3rd carrier operating between Madagascar and Mumbai belonging to a State which is a signatory to GATS, and if Madagascar is also a signatory to GATS, then Air Madagascar would **automatically** have the right to hold out services to Mumbai by code sharing with the 3rd carrier without itself physically operating. This code sharing facility would be possible because both the 3rd country carrier and Air Madagascar belong to States, which are signatories to GATS even though code sharing rights have not been bilaterally exchanged with Madagascar (or perhaps even with the 3rd country concerned). However, on such code share services, Air Madagascar can use only that much capacity and traffic rights which have been bilaterally agreed.
- Under the existing bilateral, Air Madagascar would not be allowed to operate the agreed services to Mumbai if it was substantially owned by a 3rd country (which it may very well subsequently be in today's trend of increasing privatisation). In such a scenario, if DC were to be included under a multilateral framework, then Air Madagascar would **automatically** be in a position to operate the agreed services and exercise the traffic rights that have been bilaterally agreed provided Air Madagascar meets the criteria laid down, viz. it is incorporated and has its principal place of business in Madagascar.

In short, inclusion of CS and DC under a multilateral framework would enable airlines to **utilise** rights that have been negotiated bilaterally. It would always be understood that utilisation can never exceed the bilateral agreement on the core areas.

Code Sharing and Designation Criteria have been proposed as new additional sub sectors and do not fall within the scope of existing subsectors included in GATS. There is no need to bring in hard rights to discuss these issues as these issues can be discussed independently on their own merit. The basic formulation is that all States which are signatories to GATS would confer on each other the right to operate services through code sharing including with 3rd country signatory airlines provided all airlines hold the necessary route, operational and traffic rights (negotiated bilaterally) and also designate airlines which are incorporated and have their principal place of business in their home State. In a way, this would be similar to the International Air Services Transit Agreement, which automatically grants all signatory States the right to overfly and make technical landings (irrespective of the bilateral agreements).

There are two other areas that could be considered for inclusion in GATS. These are:-

(a) *Operation with leased aircraft*

The substantial ownership and effective control clause in certain cases precludes the possibility of an airline operating with leased aircraft. India has nevertheless permitted the agreed services to be operated with leased aircraft under certain bilaterals subject to the aircraft being painted in the livery of the designated airline, the terms and conditions of the lease agreement being acceptable to the Indian authorities, and the airline being responsible for the operating procedures and flight safety and also for the performance of its own commercial operations.

India should support inclusion of this item under GATS provided that conditions applied to operation with wet-leased aircraft are as stringent as those currently applied by the

Indian authorities - i.e. they be painted in the lessee's livery - as this would otherwise lead to an abuse of bilateral entitlements and hawking of traffic rights.

(b) *Routing flexibility*

Air services are operated to and through points which are specifically laid down in the Route Schedule annexed to the Air Services Agreement, and 3rd/4th and 5th freedom rights are permitted to/from these points. While such 3rd/4th and 5th freedom traffic rights are specifically agreed under the bilaterals, India is now increasingly permitting airlines to have routing flexibility which would enable it to operate via **any** intermediate points or to **any** beyond points but **without** 5th freedom rights (unless specifically agreed).

Inclusion of this area under GATS would imply that all signatory States would grant each other's airlines full routing flexibility to operate to/from non-designated points provided it is without 5th freedom rights.

4.3 Position on bilateralism versus multilateralism

The preceding discussion noted that most countries have been staunchly opposed to introducing core areas such as capacity entitlement and market access via exchange of traffic rights under GATS. Moreover, the large number of MFN exemptions in this sector, including by important countries like the US and the EU indicates that parallelly, even for the limited areas that are covered by GATS, the bilateral regulatory system will continue to hold in air transport services. Overall, there is limited interest on the part of developed and developing countries (barring countries with small domestic markets like Singapore and the Netherlands) in extending the multilateral framework to air transport services.¹³

Global position

Preference for a country-to-country based bilateral system of liberalization over multilateral liberalization under GATS, particularly in the core areas has been argued on various grounds. One major problem is in the application of the MFN principle to liberalization in the core areas. The latter principle would require that opportunities granted to one country would have to be automatically and unconditionally granted to all countries, which are signatories to GATS. Therefore, the MFN principle would threaten the principle of sovereignty that is integral to the international air transport industry. Countries would prefer to negotiate and exchange opportunities on a one to one basis depending on reciprocity and balancing of benefits.

A second argument that is advanced is that there is already an elaborate international regulatory system governing this sector (under ICAO and IATA) which has adequately addressed the sector's needs and interests in this sector. Many of the multilateral programmes and activities developed by the airline industry through ICAO and IATA are congruent to a great extent with the main GATT principles of transparency and national

¹³ The issue of multilateralism versus bilateralism was extensively debated in ICAO-first at the Colloquium held in 1992 and then further at the 4th Air Transport Conference in 1994.

No consensus was reached primarily because the vast majority of countries, including most of the developed economies, supported continuation of the bilateral framework.

treatment. Therefore, there is little need to replace a well functioning multilateral system. Furthermore, there are also very liberal arrangements already in place under the “Open Skies” agreements between the US and several like-minded countries.

India’s position

The Indian aviation sector also holds the position that bilateralism is the preferred mode for liberalization in air transport services and that the present bilateral system of agreements can better address the needs of this sectors. In fact, its view is that multilateralism would give pose many more challenges for the weaker and smaller carriers such as Air India, thus putting them at a greater disadvantage. It is against the extension of GATS to core areas in this sector as the latter is likely to seriously undermine its capability to negotiate on a country by country basis, depending on its priorities.

The Indian aviation industry is concerned about the treatment of reciprocity under GATS. Since the different members of GATS vary significantly in terms of market potential and points of call, it would be very difficult to ensure reciprocity among such varied countries in a multilateral framework while this can be ensured on a bilateral basis taking into account the relative strengths and weaknesses of the parties concerned. Reciprocity is a difficult principle to apply on a multilateral basis in a sector characterized by huge disparities in size, efficiency and competitive strength among countries. The principle of MFN and non-discrimination would be difficult to apply as it would require any privileges granted by India to one country to be automatically and unconditionally extended to all signatories. While the extension of such liberalization might benefit some of the recipient third countries, there may be no specific interest on India’s part to extend this liberal treatment to the latter countries.

This position is all the more relevant in light of the fact that even the developed countries that are competitive in this sector have liberalized only to the extent that suits the priorities of their national carriers. The US, for example, has capped Air India's access on the London-Chicago and London-Washington markets to a total of 7 frequencies with the London-Chicago market having a specific restriction of 3 frequencies. For removing this cap USA has tabled a lot of issues that were structured to safeguard and further the interests of its national carrier. Similarly, Canada which was earlier a signatory to the IASTA has now withdrawn from it to gain leverage in its bilateral negotiations with other countries.¹⁴ Therefore, India’s stand on pushing for progressive and phased liberalization on a bilateral basis, in tune with its national priorities and interests, and given its weak domestic air transport sector, is an understandable one. Bilateral arrangements, however, must be administered in a dynamic manner so as not to stifle the Indian tourism industry. If India shies away from the prospect of liberalisation in the civil aviation sector, then India’s tourism sector will continue to operate much below its potential.

The Indian aviation industry is also concerned about the guaranteeing of fair competition under GATS. Safeguards such as commercial agreements, which act as balancing mechanisms for non-utilisation of opportunities by weaker carriers like Royal Nepal Airlines, would not be available under GATS. This would hurt weaker and smaller

¹⁴ In fact, when AI wanted the flexibility to route its Chicago flights via Toronto, the Canadians were unwilling to allow Indians transiting on board to travel without Canadian visas. They were also unwilling to allow Air India to serve Vancouver via London over the Atlantic even though Vancouver is available to Air India on the Trans Pacific route.

airlines, including AI, which does not utilize its capacity entitlements fully and makes use of such safeguards.

There are also infrastructural constraints to liberalizing under a multilateral framework in air transport services. Presently, infrastructure catering to this sector is developing at a far slower pace than is required to meet the needs of a growing air transport services sector. It is also not sufficiently market oriented. If liberalization is undertaken multilaterally, then these infrastructural limitations are likely to become even more serious as the pace of liberalization is likely to increase relative to the country by country bilateral framework. While there is scope in the developing countries to increase infrastructure such as slots, runway, terminal capacity, new airways, etc. with induction of new technology, there is little scope for similar expansion in the developed countries where infrastructure bottlenecks have already developed. This could effectively preclude developing countries from actually benefiting from additional market access under GATS. Also, in a system of bilateral negotiation of hard rights, the developing countries would have the option to link any exchange of rights to their airlines being guaranteed slot availability.

The bilateral system would similarly be more effective in dealing with several of the other external constraints discussed earlier. For instance, in the case of immunity and anti-competitive practices, although there is no fundamental problem with whether this issue is negotiated multilaterally or bilaterally, the real question is whether the US or the EU is amenable to granting such immunity in the first place on a multilateral basis. Moreover, there would also be administrative and funding problems in setting up a multilateral agency to formulate a common competition policy acceptable to all and then to enforce it. Likewise, with regard to repatriation of earnings, the bilateral system would enable reciprocal retaliation if a country imposes restrictions on the repatriation of foreign exchange earnings. In a multilateral framework, if India were to extend repatriation facility - which it does - to any one country, then the same privilege would have to be unconditionally extended to all countries and there would be limited scope for taking reciprocal action against any one country.

Thus, underlying the universally stated preference for a multilateral regime lie some very real divergences in economic interests regarding air services, based on the country's home market and the competitiveness of its national airline. Multilateralism is an obvious choice for one or two countries that have strong airlines but limited home markets and have little left to offer in return for additional rights under the bilateral system of agreements. These include countries such as Holland (KLM) and Singapore (Singapore Airlines). Conversely bilateralism would appeal to the vast majority of countries, including India, with substantial markets but whose national airlines are at a disadvantage in terms of size and efficiency. Only a few countries, such as the US, have both a large home market and large efficient airlines and could survive under either system. Therefore, the collective view that emerges is that liberalisation in air transport must be gradual, orderly, progressive and safeguarded and that core rights-capacity entitlements and market access – must remain outside GATS.

The Indian aviation industry's position is that India should continue with the existing policy of encouraging new air links with various countries and selectively reviewing the opportunities available under the existing bilaterals while at the same time avoiding concentration of opportunities in India in the hands of a few mega airlines. The bilateral system would be more effective in controlling and monitoring critical factors such as capacity and tariffs. For instance, capacity would be easier to monitor under the bilateral system as capacity entitlements are clearly laid down in the bilaterals and schedules of airlines are cleared only if they are in accordance with the entitlements. Multilateral

liberalization would make it difficult to control and monitor capacity. Similarly, the degree of control over tariffs (the net market fares that are paid by passengers, i.e., charged by airlines) would be significantly reduced under a multilateral system. Hence, multilateral liberalization could lead to an unhealthy scenario with regard to vital areas such as capacity and tariffs, thus jeopardizing the interests of smaller players like India in the international air transport market.

4.4 Issues for negotiation and consideration

There are many issues of interest to other countries in their negotiations with India. These issues will either emerge in their discussion with India at the WTO or in the context of new or existing bilateral ASAs. India should be prepared with its position on all these areas as outlined below. It is to be noted, that most of these issues will have to be addressed bilaterally under the system of ASAs as is also indicated below.

One of the primary interests of other countries would be to obtain increased entitlements and access to interior points in the country. India should selectively liberalize on entitlements and market access under the bilateral system on a country -to-country basis based on its priorities. Granting of access to interior points must be dealt with caution as this is the main strength of the Indian carriers and competition in this regard could adversely affect AI and IC. In this regard, further declaration of international airports in the country should be carefully considered. Market access to foreign carriers is restricted to airports declared as "international", viz. Mumbai, Delhi, Calcutta, Chennai and Trivandrum. The main strength of the Indian carriers is singular access to the hinterland and this advantage would be grossly diluted if additional interior airports are declared as "international" and access granted to foreign airlines.

Another issue of interest for other countries is that of code sharing with domestic carriers. Since this would provide indirect access to interior points for the foreign carriers, again this is an area that must be dealt with cautiously in the context of bilateral agreements.

Countries are also interested in the removal of commercial agreements, which as noted earlier, act as a balancing mechanism, and provide a quid pro quo for non-utilisation of rights by the Indian carriers. Such agreements can also act as a deterrent for unhealthy market practices. It is in the interest of the Indian carriers to continue with this policy. Again, this is an issue to be discussed bilaterally in the existing or new ASAs.

Countries are also interested in pushing for double disapproval of fares which is accepted as the most liberal system of fare approvals. However, the latter system does not provide any scope for the weaker party to take protective action. India has accepted the country of origin approval system in some cases - which is fairly liberal - and should continue with this approach.

Change of gauge is another point for negotiation with other countries. Only a few old ASAs provide for change of gauge. There is a lot of interest in obtaining this facility, including by the US. Recently, a request has been received in this regard from the US. India could use such requests as a bargaining tool in its bilateral negotiations to address the interests of the Indian carriers.

Foreign carriers seek co-terminal facility in India, i.e., serve two markets in India on the same flight. In order to encourage operations to Calcutta, India has been allowing the facility to combine Calcutta with a primary gateway such as Mumbai and Delhi. However, in principle, this facility is not extended to combine the prime gateways of

Mumbai and Delhi. India should move slowly in this area as providing extensive co-terminal facility to foreign airlines would put AI as well as the domestic airlines at a disadvantage by cutting into their market.

Countries want the flexibility to set up ground handling units to service not only their own carriers but also other carriers. Some foreign carriers have been seeking this facility in India. However, it must be noted that ideally, major international airports should not have more than three handling agencies with a proven track record to provide ground handling services. From the point of view of safety and security requirements of the aviation sector, it is not in the best interests to permit entry of too many operators. Moreover ground handling is a capital intensive industry involving heavy investment in manpower resources and equipment. The large fleet of ground handling equipment requires not only a lot of space for parking but also infrastructural facilities to maintain this equipment. Introduction of many players at the international airports would put further strain on the limited facilities.¹⁵

As noted earlier, slots have emerged as a major constraint in a number of congested airports abroad. Granting of additional traffic rights to foreign carriers with countries having such airports must be linked to an assurance on viable slots for Indian carriers there. If non-availability of slots prevents Indian carriers from utilising entitlements, then similar retaliatory action needs to be considered in India.

Certain IATA reports suggest that all-cargo services are being viewed as a strong candidate for inclusion in GATS. The fact that India has already implemented an Open Policy for all-cargo services from May 1992 would, on the face of it, appear to support the inclusion of all-cargo services under GATS. However, India should cautiously approach the inclusion of all-cargo services in GATS for the following reasons:

- If cargo is included, it would inevitably lead to pressures for inclusion of passenger services in a short time
- In the GATS framework, India would lose its option of withdrawing the open sky principles if it so desires in the future.
- India has formalised the open sky principles for all-cargo services in the bilaterals with some countries which ensures reciprocity for the Indian carriers. If all-cargo services are included in GATS, then a signatory State need not extend such reciprocal facility to the Indian carriers provided such a facility is not extended by

¹⁵ Air India has invested massive resources in the area of manpower and equipment, which are based on their major share of ground handling of foreign aircraft at Indian airports. These resources would be left grossly underutilised in case of erosion in ground handling contracts due to the presence of other agencies. It would also reduce AI's bargaining power while negotiating ground handling contracts at foreign stations.

Indian Airlines also provides Ground Handling to its own flights in India at all domestic Airports except Cochi and to foreign airlines on regular basis at Delhi, Mumbai, Calcutta, Chennai, Trivandrum, Trichy, Bangalore, Hyderabad, Ahmedabad and Goa in India. In addition Indian airlines provides Ground Handling Services to Charter Flights and VVIP flights of foreign countries at stations like Agra, Jaipur, Goa and Jodhpur where no other Ground Handling exists. Indian airlines earnings from ground handling are approximately Rs.80 crores per year, a major portion whereof is in foreign exchange. Foreign airlines are permitted to handle their own flights at Airports in India. However, they are debarred from handling flights of Airlines other than their own. Implication of opening up the ground handling facilities to foreign operators to the extent of their engaging in this activity as a business proposition will be to the detriment of existing handlers i.e. Air India, Indian Airlines and Combata Aviation. This will also result in congestion of Ground Handling equipment which apart from increasing costs also will increase the chance of accidents on ground at airports in India.

that State to any other carrier. The MFN principle favours the country, which has the least liberal policy. India will therefore have little to gain from inclusion of all-cargo services under GATS.

Here one must point out that at present two thirds of all cargo carried in & out of the country is by passenger aircraft with only one third being carried by dedicated freighters. It therefore follows that allowing more passenger flights into the country would have a beneficial impact on air cargo facilitation for Indian exporters and on rates.

Thus, in all of the above issues, any liberalization by India should ensure reciprocity of economic benefits between Indian carriers abroad and foreign carriers in India. It must be accompanied by safeguards and negotiations of quid pro quos which guarantee participation of the Indian carriers in the economic benefits from liberalisation. This is very important in a world where most of the developed countries have taken MFN exemptions and resorted to bilateral agreements in air transport services to suit their interests.

5. Domestic Reforms in the Air Transport Services Sector

As discussed earlier, the Indian domestic sector is faced by many domestic and external constraints. Currently, it is not in a position to exploit the market access offers made by importing countries under GATS. Therefore, if India is to expand its capability of providing tradable services under GATS or even under the system of bilateral agreements, it will have to introduce several measures and reforms. These include, policy shifts in favour of attracting massive private investment in infrastructure for air transport services, enunciating a comprehensive policy framework on air transport services, and empowering an independent, autonomous, regulatory authority on air transport services.

5.1 Required measures

First and foremost, the domestic air transport services sector will need to be strengthened. Integral to this is the privatization of the national airlines. The Finance Minister, in his budget speech of 1998, listed Indian airlines for privatisation. The Disinvestment Commission has recommended privatisation of Air India with injection of funds by a strategic partner who would hold a 40 percent stake in AI with the domestic retail investors and employees holding 20 percent and the government holding the balance of 40 percent. However, to implement this recommendation, the current national policy, which debar foreign airlines or their subsidiaries from holding a stake in domestic carriers, would have to be modified or made non applicable to the case of AI. This is because typically only an airline would provide funds and form an alliance with another airline. In addition, the strategic partner (a consortium of airlines and investors) must be given appropriate share in the management and permitted to expand the fleet.

The government will also have to provide Rs. 1,000 crores as equity to financially restructure AI as per the Commission's recommendations and enable it to downsize so as to make the airline a viable option for a strategic partner. The government therefore needs to move quickly to restructure the airline, to devise a time frame for disinvestment, and to take a decision on which AI's strategic partner will be. Given the current financial condition of AI, urgency is required in the latter regard.

The government will also need to give AI more flexibility in its agreements with the various employee unions to help mitigate the problem of overstaffing and low

productivity. In this connection contracting out of some the activities will now be permitted to reduce the inhouse workforce. However, these activities will be subject to audit so that service quality standards are not compromised and sub contracted personnel not exploited. In addition, improved performance by the airline will require increased customer orientation and better staff morale. The government must distance itself from ownership of the national carriers and enable the airlines to run their business as competitive economic enterprises that maximize returns for key stakeholders rather than meeting various government mandated objectives which put them at a competitive disadvantage. The government's role should be redefined as a supporting one where it frames the policies to create a regulatory environment that is conducive to competition and efficiency and the infrastructural and security needs of the sector.

Another issue that will have to be addressed domestically is that of competition laws which are presently absent in India. If India is to make any commitments in this sector, liberalisation must be accompanied by competition laws in the areas of fares and market practices. There should also be an effective monitoring mechanism to ensure immediate remedial action in the event of any contravention.

Another area to be addressed domestically is that of route rationalisation for domestic operators and between AI/IC. There should be a level playing field for all Indian domestic operators in terms of route operating compulsions vis-à-vis trunk and secondary routes. By the same token, the decision requiring Air India to withdraw from domestic routes needs to be reconsidered on the grounds of fairness given that Indian Airlines can continue to expand into Air India's prime routes.¹⁶

Finally, the government must take steps to privatise airports. In December 1997, the Government of India, realising the importance of airport infrastructure in the overall development of the aviation sector, brought out a Policy on Airport Infrastructure. The broad objective of the Policy is to provide a boost to the international trade and tourism, create airport capacity ahead of demand, enhance airport facilities to achieve higher level of customer satisfaction, to provide multi-modal linkages, provide market orientation to the present structure, generate additional resources, encourage transparency and clarity in decision making process etc.

In order to achieve the objectives set out in the Policy, there is an imminent need to tap all available resources be it in the public or the private sector. It is well understood that the airport infrastructure is a capital intensive sector with projects involving large elements of sunk cost, a very long gestation period and highly uncertain returns on investment. As such, to encourage the private sector to invest in the development of airport infrastructure, a flexible and positive approach is called for. Keeping this in mind, Policy permits corporatisation and privatisation of airports with a high degree of flexibility in ownership and management of airports in the country. This shift from state owned structure of airports to distinct and separate corporate entities with the final aim being corporatisation of such entities is in consonance with the world view.

The implications of the privatisation of major airports can be summarised as follows: -

¹⁶ The government should, however, not designate private operators as international carriers. Barring a few countries, most others have one or at most two national carriers for international operations. Since the international market is already fiercely competitive, adding to the competition by a multiplicity of international airlines would be counter-productive, as it would only redistribute the market among a larger number of players.

- Resource crunch currently experienced in creating infrastructure of world standards would, to a large extent, be offset by private sector investment.
- A greater efficiency and enterprise in the operation of airports would be achieved by the introduction of appropriate management skills in vogue in the private sector. This would ensure a better and a higher return to the stakeholders including the Government of India.
- The Government of India can, subsequent to the privatisation, concentrate on the development of infrastructure in the North East and other inaccessible areas and divert the scarce resources to these areas. This would ensure more balanced and equitable development of various regions.
- Privatisation would necessarily involve certain issues relating to the employees and as such would call for creating suitable mechanisms for a smooth transition from the public to the private sector.
- Privatisation would involve certain issues relating to Security, Customs, Immigration etc., which hitherto are provided by the Government of India. The extent to which these areas can be privatised would require serious considerations.
- The privatisation would have a bearing on the current and future expansion activities that are already planned. It needs to be ensured that during the transition period the operations of the airports are continued without any interruption.

In order to ensure that the privatisation exercise become successful, it would be imperative to ensure that a transparent regulatory authority is created to look into various grievances with regard to fixation of tariff rates, allotment of slots, space at airports etc. In this regard, it would be necessary to look into the various Acts, Rules and Regulations currently governing the sector to bring out a local framework which would provide a conducive environment to the simultaneous existence of both the private and the public sector.

Privatisation of airports would greatly help in upgrading the infrastructure and quality of facilities in the aviation sector. Once an airport is privatised, the emphasis of the airport management would be to maximize the revenue earnings from the existing facilities. To achieve this, the management would also be keen to attract more operators to the airport and would lobby for foreign carriers to be granted market access to these airports.

Presently, barring a few exceptions like Air Lanka and Royal Nepal Airlines, foreign carriers are allowed access under the bilateral to only the five designated “international” airports, viz. Mumbai, Delhi, Chennai, Calcutta and Trivandrum. Once the airports are privatized and foreign carriers are allowed market access to interior points, there would be increased competition for Indian carriers who would lose their monopoly in terms of singular access to these points.

5.2 Future prospects for liberalization

Given timely implementation of the aforementioned measures and reforms, the domestic air transport services sector can be strengthened and made more competitive over a time frame of 10 to 15 years. If AI is privatised, it can be turned around to a lean and robust organization. With privatisation and subsequent growth and return to profitability, AI will be better placed to take full advantage of its strengths and opportunities, be it under the bilateral or the multilateral framework. However, till that

time, liberalization will have to be gradual and managed. Most developed countries have followed this policy and India will not be an exception by doing likewise.

It is therefore recommended that there be no immediate move to a multilateral framework in view of the proven record of the bilateral mode to safeguard India's interests, while providing virtually all the flexibility needed to trade benefits. There should be a phased progression towards multilateralism by first trading soft rights such as code sharing, designation criteria for international services, landing fees, airport charges, and customs duties on spare parts and fuel. During the transition period, steps can also be taken to move towards plurilateral accords with like-minded groups. Progress towards multilateralism can be considered only over an extended period of time when India's national carriers are prepared to face more extensive competition and can benefit from the forces of competition.

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