

Liberalisation of Civil Aviation in South Asia

Institute of Policy Studies
Sri Lanka

3rd South Asia Economic Summit,
Katmandu, Nepal
December 2010

Outline

- Background
- Economic Impacts of air service liberalisation
- Introduction to Air Service Agreements (ASAs)
- Global Trends
- ASAs in South Asia
- Current Air Connectivity in South Asia
- Short Term measures to boost connectivity
- Long Term road map for air services liberalisation in SAARC
- Wrap Up – key observations, way forward



Background

- South Asia remains one of the least integrated regions in the world – in terms of trade, transport and people to people connectivity
- Mutual interdependence between economic and transport integration
- Lack of direct capital-to-capital connectivity in many cases (e.g. Sri Lanka-Bangladesh, Sri Lanka-Nepal, Pakistan-Sri Lanka among others)
- International air services are governed by bilateral Air Services Agreements (ASAs)
- Specifies limitations on air traffic rights, number of airlines allowed to operate, capacity, tariffs and destinations that can be operated on flights between two countries.
- Objective of the study was to identify factors which inhibit air connectivity in South Asia and to suggest policy measures that could lead to greater air connectivity



Background – *liberalisation is not easy*

- Global air services are among the most restricted and regulated sectors of international exchange
- ASAs are notoriously opaque – much information is not publicly available due to confidentiality clauses
- De-regulation of air services is not easy – balancing national interest, regional interest, consumer interest, special-interests, etc.
- Beneficiaries of liberalisation are numerous, spread out and receive relatively smaller marginal benefits
- While losers are large – usually politically influential industries such as entrenched domestic airline monopolies



Background - *key highlights from other studies...*

- Many studies looked at the effect of air services restrictiveness on airfares
 - Most of these found a reduction in airfares, as well as increase in imports coming by air
 - Also found a resultant increase in air passenger flows
 - Applies to evidence from both developing and developed countries, but in varying magnitudes
- Many studies also looked at the change in volume of air traffic vis a vis the degree of liberalisation
 - Found that greater liberalisation had increased traffic volumes



Institute of Policy Studies of Sri Lanka

Economic Impacts

- Removal of barriers in the short-run reduces prices, creates some jobs
- In the long-run, liberation will have a catalytic effect, creating more trade and jobs (not only in aviation sector), results in new lower price
- Direct impacts – growth of employment in air services sector
 - New airlines, new airline branch offices, flight crews, administrative staff, technical staff, airport expansion and ground handling services
- Indirect impacts – lower restrictions on designation and capacity could increase destinations and frequencies
 - reduces the cost of doing business between countries and open up options for new markets – implications for trade and investment
 - Encourages third party investment in airlines and support services
 - Potential for enhanced tourism, and passenger flows in general



Institute of Policy Studies of Sri Lanka

Economic Impacts – *air cargo*

- 29.9% of all world trade is transported via air cargo, McKinsey states this is likely to rise to 80% by 2020
- Close to 50% of air cargo is transported on passenger flights, not on dedicated cargo flights!
- So significant automatic spillover effects of growth in passenger flights for growth in air cargo transport
- Stakeholder interviews revealed that in South Asia air cargo operates in a regime close to open skies, but other impediments prevailed
 - Airport infrastructure not ideal, outdated security clearance measures
 - Singapore – goods can be cleared in 3 hours, while in Chennai it can take up to 12 hours
 - Hinterland transport connectivity is weak – difficult to export perishable items in a competitive manner
 - Monopolies on ground handling – high costs, inefficiencies



Institute of Policy Studies of Sri Lanka

Economic Impacts – *regional production networks*

- In US and EU, accelerated development in air services (through removing restrictions) was prompted by the growth in global and regional production networks, JIT logistics, etc (*Tham, 2008*)
- These networks required strong support services – e.g. air travel
- An stronger plan of regional integration is necessary in South Asia, promoting intra-industry trade in the region, regional value chains, etc – this will spur on demand for logistics connectivity – key element is air services and air freight



Institute of Policy Studies of Sri Lanka

Features of ASAs that restrict air services

- Grants of rights – esp. 5th freedom, 7th freedom, cabotage
- Capacity - restrictions on volume of traffic, frequency of service, aircraft types – 'Bermuda I' (limited right to airlines w/out prior government approval), 'free determination' (no regulatory controls)
- Tariff approval regime – price determination – 'dual approval' to 'no restrictions'
- Withholding – restrictions of ownership of airlines, requirements of substantial domestic ownership and even for the airline to be the national carrier to gain access
- Designation – defines the number of points between the two countries that airlines can fly into
- Cooperative agreements – Regulates creation of airline networks and code sharing
- Exchange of statistics – Enables monitoring of traffic and other aspects



Institute of Policy Studies of Sri Lanka

Grant of Rights

(Freedoms 1-4 are standard in most ASAs)

5th FREEDOM

- To carry freight and passengers between two countries by an airline of a third country *on route with origin / destination in its home country*

6th FREEDOM

- To carry freight and passengers between two countries by an airline of a third country *on two routes connecting in its home country*

7th FREEDOM

- To carry freight and passengers between two countries by an airline of a third country *on a route with no connection with its home country*

8th FREEDOM OR CABOTAGE

- To carry freight and passengers *within a country* by an airline of another country on a route with origin / destination in its home country



Institute of Policy Studies of Sri Lanka

Global Trends in Liberalisation

- 5th freedom traffic rights are granted in 2/3rds of all agreements, covers close to 80% of global traffic
- Multiple designation appears in 1,063 covering 80% of global traffic
- Restrictions on ownership (substantial ownership and effective control criterion) remains overly dominant – 90% of total traffic
- Capacity predetermination is also dominant – 44% of world traffic – 'Bermuda I' accounts for 26%, 'free determination' only in 18%
- Dual approval of tariffs is the most dominant – 73% of total traffic – but in practice this is not implemented with rigour (new online booking, differential fares paid on each flight, makes it harder to track and enforce)
- Allowing for cooperative arrangements are found in ASAs governing only 25% of world traffic, but in practice these are more widespread



Institute of Policy Studies of Sri Lanka

Status of ASAs in South Asia

- Air Services Liberalisation Index (ALI) selects key features of bilateral ASAs that affect air traffic and gives scores according to the degree of liberalisation of each feature
 - i.e. designation, withholding, tariffs, capacity, traffic rights, absence of exchange of statistics, allowance of cooperative arrangements
- For example, 'dual approval of tariffs' (a very restrictive provision) is attributed zero points, whereas 'free pricing' (the most liberal of the tariff provisions) is given eight points
- The maximum ALI score that is possible is 50
- How do South Asian ASAs score? - very restrictive, the highest ALI (standard) being 10 out of 50



Institute of Policy Studies of Sri Lanka

ALI - South Asia

Air Liberalisation Indices of South Asian ASAs

Bilateral ASA	ALI Standard	ALI 5+	ALI O+	ALI D+	Type
Sri Lanka Pakistan	8	13.5	6.5	7	i
Sri Lanka India	6	12	5	5.5	c
Bangladesh India	10	15.5	8.5	13	e
Bangladesh Nepal	6	12	5	5.5	c
Pakistan Nepal	6	12	5	5.5	c

Type of ASA:

I = incomplete data

C = 3rd, 4th and 5th freedom, double approval of tariffs, single designation, substantial ownership and effective control, pre-determination of capacity.

E = 3rd, 4th and 5th freedom, double approval of tariffs, multiple designation, substantial ownership and effective control, pre-determination of capacity.

Source: WTO Air Services Liberalisation Analytical Tool (www.wto.org)



Institute of Policy Studies of Sri Lanka

ALI – Global

- Globally, ASAs don't score too high either...

Weighted Air Liberalisation Index of high-traffic bilateral Air Services Agreements

ASAs concerned	WALI
Top-67 ASAs	16.6
Top-100 ASAs	16.1
Top-200 ASAs	15.4
All QUASAR ASAs (1970)	14.0

Source: WTO Secretariat (2006)

-but yet score higher than South Asia ASAs on average



Institute of Policy Studies of Sri Lanka

ASAs between S. Asian Countries and Selected Extra-Regional Countries

- South Asian ASAs within the region are more restrictive than S.Asian ASAs with parties outside the region

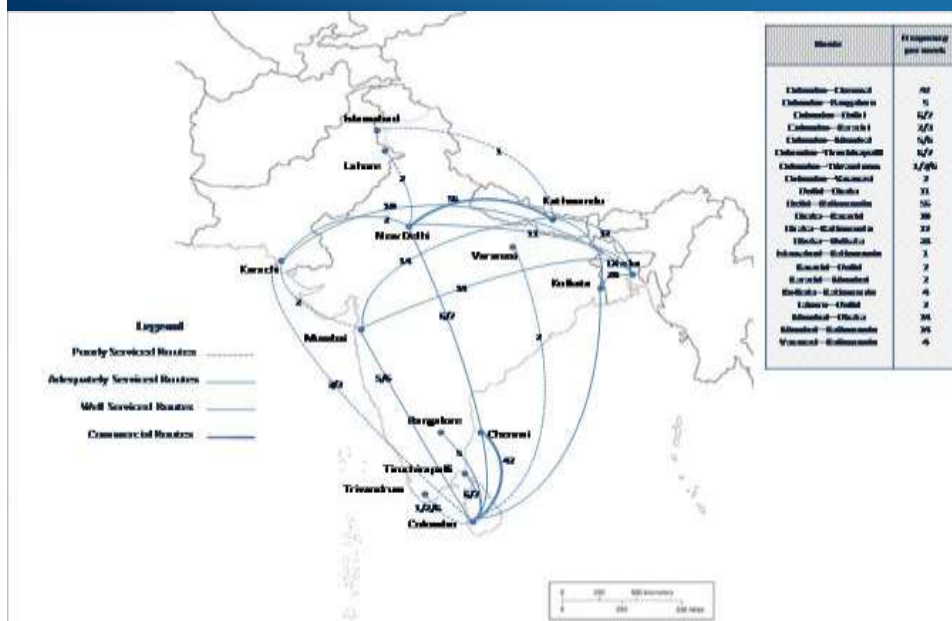
Country	Singapore				Japan				UK			
	St	5+	O+	D+	St	5+	O+	D+	St	5+	O+	D+
Sri Lanka	14	19	12	16.5	10	15.5	8.5	13	14	12	12	16.5
India	10	15.5	8.5	13	12	17	10	14.5	10	15.5	8.5	13
Pakistan	14	19	12	16.5	-	-	-	-	14	12	12	16.5
Nepal	17	21.5	14.5	15.5	10	15.5	8.5	13	8	7	7	11
Bangladesh	10	15.5	8.5	9	6	12	5	5.5	-	-	-	-

Source: WTO Air Services Liberalisation Analytical Tool (www.wto.org)



Institute of Policy Studies of Sri Lanka

Air Connectivity in South Asia



Air connectivity in South Asia – *Current Status*

- It is evident that there are only 3 commercially attractive routes in the region (more than double daily flights) – Colombo Chennai, Delhi Kathmandu and Dhaka Kolkata.
- Mumbai-Kathmandu and Mumbai-Dhaka are well serviced routes with double daily flights
- Only 3 other routes have more than 10 flights a week, that is flights between Dhaka and Karachi, Kathmandu and Delhi
- Considering a country by country basis, it is clear that India is the most connected country in the region whilst Pakistan is the least connected in the region
- Sri Lanka has no direct flights with Nepal or Bangladesh and to reach these countries passengers must travel via either Bangkok, Singapore, Middle East (Dubai, Doha), or Delhi (only recently)



Institute of Policy Studies of Sri Lanka

Country to Country connectivity

Connectivity by Country in South Asia (Flights per week)

	India	Pakistan	Sri Lanka	Bangladesh	Nepal
India		6	79	53	78
Pakistan	6		3	10	1
Sri Lanka	79	3		0	0
Bangladesh	53	10	0		12
Nepal	78	1	0	12	

Source: South Asian Airline Websites

- Capital-to-capital - Colombo is not connected directly with Dhaka, Kathmandu or Islamabad
- Islamabad is only connected with Kathmandu – and that too just one flight a week



Institute of Policy Studies of Sri Lanka

Insights from Stakeholder Consultations

- Clear that South Asia has restrictive air connectivity and restrictive ASAs – however it is necessary to ascertain whether the former is caused by the latter or whether there are other factors in play
- Interviews with key airlines and CAAs in the region - Airlines included Sri Lankan Airlines, Jet Airways, Kingfisher and also the Civil Aviation Authority of Sri Lanka and the Ministry of Tourism and Civil Aviation in Nepal
- Despite best efforts to interview Pakistan International Airways (PIA) and Bangladeshi airlines, it was not possible to secure such an interview
- Key insight – Perception that regulatory factors were secondary to commercial viability in the region
 - Influenced by low incomes, limited commercial interest and restrictive visas
 - BUT, liberalisation measures like allowing code-sharing was quickly identified as a boost-factor



Institute of Policy Studies of Sri Lanka

Insights from Stakeholder Consultations (cont..)

- Code sharing - Civil aviation regulatory bodies in the region place restrictions on code sharing in some cases
 - Pakistan and Bangladesh do not allow code-sharing between two 3rd party airlines, expect all agreements to take place with their national carriers
 - However, regional airlines (e.g. SL) are reluctant to code-share in some cases due to divergences in quality and safety standards
- Operational costs – Commercial viability can be enhanced by reducing operational costs – ground handling costs and other airport charges
 - Priority to infuse competition in airport services, break existing monopolies
 - Re-fuelling charges and baggage handling costs in SL are higher than may competitors
- Immigration bottlenecks - immigration laws, visa processes undermine smoother connectivity and are a disincentive to travel (e.g. India transit?)



Institute of Policy Studies of Sri Lanka

Insights from Stakeholder Consultations (cont..)

- Geographic Issues – Higher cost of operating flights to Kathmandu during the night due to requirement of special pilot qualifications – the low demand for such flights makes this un-economical
- Political Issues – India – Pakistan flights should be commercially viable given the relatively economic development of these economies – however political constraints have compromised negotiations between airlines
- Challenges – spurring low cost carriers (LCCs) – undermine profitability of FSCs without necessarily creating new routes? (but in other regions FSCs and LCCs have co-existed simultaneously)
- Infrastructure – although not significantly affected by shortfalls in infrastructure, both in terms of airport capacity and airline capacity. But both of these issues would be important to rectify in the long run in order to accommodate potential increased traffic in a liberalised environment



Institute of Policy Studies of Sri Lanka

Lessons from India-Sri Lanka Air Services Liberalisation

- Liberalisation began in the early 2000s – allowed increased capacity and liberalised designation
- Enabled more Sri Lankan Airlines flights into India
- By mid 2000s Sri Lanka had the most flights into India from any foreign country with up to 110 flights a week
- Sri Lankan Airlines was able to position itself as a gateway into India as a result of the more liberal air services regime
- Very shortly after liberalisation Jet Airways and Sahara opened operations in SL
- Important factor overall was also the relaxation of visa requirements by Sri Lanka – enabled Indians to obtain tourist visa on arrival in SL
- This created demand and made flights between India and SL more commercially attractive
- This shows that for air connectivity to increase it requires both a relaxation of bilateral ASA regulations and the creation of a commercially viable market



Institute of Policy Studies of Sri Lanka

Lessons from Other Regions

- ASEAN
 - Role of sub-regional ASAs e.g. CLMV - enabled gradual build up of competitiveness and can phase in liberalisation
 - Phased approach to liberalisation – 3 phases (2007 – 2012)
 - Removing investment and ownership controls, permitting multiple designation, removing route capacity controls, relaxing restrictions on gateways, etc.
- EU
 - Also 3 phases – began with reduced restrictions on capacity and designation, eased tariff restrictions
 - Second stage – even greater flexibility in tariff setting, extension of 3rd, 4th, 5th freedoms across Europe
 - Third stage more complicated – common licensing, community carrier (where majority owned and controlled by European interests could operate anywhere in Europe), complete tariff liberalisation



Institute of Policy Studies of Sri Lanka

Short-Term Measures to Boost Connectivity in SAARC

- Enabling code sharing with third party airlines (e.g. Colombo-Dhaka route)
- Reducing operational costs in the region – liberalising ground handling
- Grant of 5th freedom rights on certain routes
- Simplification of transit visa processes – e.g. SL visa relaxation for Indians spurred demand for flights between the two countries
- Need to be supplemented by greater overall investment in airline related infrastructure (airport capacity, safety, etc.)
- However, significant driver of increased connectivity is greater demand for travel within the region → requires greater regional integration in general (commerce, tourism, people to people connections)



Institute of Policy Studies of Sri Lanka

Longer Term Road Map – *from bilateral ASAs to regional*

- Investment in airlines to enhance competitiveness and quality (to support code sharing as well) – possibility of encouraging greater foreign equity in national airlines
- Start with easing restrictions on withholding – creates space for foreign investment in airlines to enhance quality and magnitude of services – Important for enabling code sharing and ability to increase flights
- Ease restrictions on designation (double) and capacity (Bermuda I) - This can help smaller countries tap into Indian market like SL was able to enter into the Indian market as a result of increased flights allowed into Indian cities (important parallel measure was visa on arrival in SL)
- Overall - tariff liberalisation, ownership as principal place of business, and extension of 5th freedom across the SAARC region



Institute of Policy Studies of Sri Lanka

Wrap Up – *Key Observations*

- Regulatory issues as per bilateral ASAs in the region, are fairly restrictive, but several other related issues that have caused the region to be characterized by limited air connectivity
- So, while efforts must be made to formulate a more liberal South Asian air services connectivity framework, the related issues like lack of/limited competition in national air transport and support services markets, need to be simultaneously addressed
- A key reason for the current low air connectivity in the region is the limited number of economically viable routes
- As economic integration and tourism increases, regulatory factors will pose greater constraints



Institute of Policy Studies of Sri Lanka

Wrap Up – Way Forward

- So, longer run - necessary for South Asia to embark on a more ambitious framework of liberalisation
- BUT important to also consider the 'quality' of liberalisation – e.g. if 5th freedom rights are granted by a country, are the allocated landing times of a commercially viable nature or not?
- Must consider dynamic effects - As regional air services connectivity is further liberalized dynamic effects may kick-in - cause certain routes that are currently commercially unviable to become viable
 - For instance, a current commercially unviable route connecting two South Asian capitals, as identified in earlier sections of this paper, may become viable due to the granting of 5th freedom rights in a country, and allowing cooperative agreements (i.e. code-sharing)
- Recall - Sri Lanka's initial moves towards open skies - unilateral liberalization of air services with India
 - highlights the positive spill over effects of such liberalization - increased tourist arrivals and greater people to people connections which stimulate investment and commerce



Institute of Policy Studies of Sri Lanka

Wrap Up – Balance and Political Will

- The key challenges for policy makers in the region will be to balance the regional interest with the national interest of countries whose carriers are likely to struggle to survive in an increasingly competitive environment.
- This would need to be driven by political will at the highest level in the region
- Closely evaluate other regional experiences of air services liberalization, and distil lessons for South Asia's own efforts
 - EU success – political maturity of the region was a key factor?
 - ASEAN was able to liberalise to a substantial degree – willingness of nations to cooperate despite not having a powerful governing body like EC
- *So - "Chicken and egg" scenario? – "is a stronger and more integrated SAARC a pre-requisite to greater air services liberalisation?"*



Institute of Policy Studies of Sri Lanka

Thank You

Blog - www.ipslk.blogspot.com

Web - www.ips.lk



Institute of Policy Studies of Sri Lanka