

# ISAS Working Paper

No. 97 – Date: 18 November 2009

469A Bukit Timah Road  
#07-01, Tower Block, Singapore 259770  
Tel: 6516 6179 / 6516 4239  
Fax: 6776 7505 / 6314 5447  
Email: [isassec@nus.edu.sg](mailto:isassec@nus.edu.sg)  
Website: [www.isas.nus.edu.sg](http://www.isas.nus.edu.sg)



## **Civil Aviation in India: An Exploration in the Political Economy of Promoting Competition**

Rahul Mukherji and Gaurav Kankanhalli<sup>1</sup>

### **Executive Summary**

The civil aviation sector in India has witnessed remarkable growth in the last few decades. This paper aims to analyse the promotion of competition in this burgeoning sector with particular focus on the political economy of several key reform events. First, the economic ideas governing policy-making institutions such as the Prime Minister's Office were important. Second, the balance of payments crisis of 1991 was important for explaining change in the sector. Third, over time, bureaucratic politics within the sector, with certain ministries supporting and others opposing reorganisation, was a key factor underlying the pace of reform. Last but not least, the ideology of the party in power also made an impact on the promotion of competition in the sector.

Indian civil aviation has come a long way since the sector was nationalised in 1953. This was the time when the Nehruvian consensus was that the “commanding heights” of the Indian economy needed to wrest with the public sector. Two government-owned national carriers, Indian Airlines and Air India, served scheduled domestic and international routes respectively. Indian Airlines enjoyed monopoly over domestic air travel in India. The period between 1953 and 1985 witnessed a decline in the efficiency with which the civil aviation sector had been served in India.

The gradual reforms of the 1980s prepared the ground for significant deregulation in the 1990s. In 1986, Rajiv Gandhi's ascent to premiership signalled a reorientation of economic policy in the direction of gradual liberalisation with the introduction of modern private carriers entering the market as air taxi operators. Significant private sector orientation arrived after the balance of payments crisis in 1991. This crisis had been precipitated by government

---

<sup>1</sup> Rahul Mukerji is an Associate Professor with the South Asian Studies Programme at the Faculty of Arts and Social Sciences, National University of Singapore (NUS). He can be contacted at [sasrm@nus.edu.sg](mailto:sasrm@nus.edu.sg). Gaurav Kankanhalli is a final year student at the United World College of Southeast Asia. He was an intern with the South Asian Studies Programme during the summer of 2009. He can be contacted at [gauravak@gmail.com](mailto:gauravak@gmail.com). The authors thank Associate Professor Gyanesh Kudaisya for his encouragement. Nur Jannah Mohamed provided excellent administrative support. Tabarez Ahmed Neyazi introduced Gaurav Kankanhalli to the use of library resources at NUS, which was indispensable for this project. The views presented in this paper are personal and do not necessarily reflect those of the Institute of South Asian Studies. Also, the shortcomings that remain, rest with the authors.

overspending, and it was understood that the state must withdraw from commercially viable sectors of the Indian economy. The civil aviation sector was opened to private airlines. The subsequent period witnessed a boom in the airline market and a general improvement in the quality of services. Further reform followed during the tenure of the National Democratic Alliance (NDA) government (1998-2004), driven by a desire to improve market orientation within the sector.

Challenges still remain for the further maturation of the civil aviation sector in India. The intrinsic conflict of interest with the government acting as a regulator arbitrating between the government-owned and private carriers is an impediment to the promotion of competition. Air India is still a loss-making entity surviving on the tax payer's benevolence at a time when government-owned telecom operators and the Indian Railways have benefited by subjecting themselves to the pressures of competition. The collusion of the regulator located within the Ministry of Civil Aviation with the national carriers has led to a high incidence of taxation both on premium seats and Aviation Turbine Fuel (ATF), as well as unreasonable conditions regarding the need to serve unprofitable social benefit routes.

The paper concludes by making a few recommendations on the future of the sector. The paper argues for an independent and autonomous regulator that will resolve the conflict of interest between the present regulator located within the Ministry of Civil Aviation that owns the national carriers, and the private carriers. A regulator that enjoys a fair degree of autonomy from the Ministry of Civil Aviation would pressure the government for the corporatisation of national carriers under government ownership, whose losses are largely due to the politicised nature of its management functions. Mature regulation and an even playing field between the government-owned and private carriers will be good for the future of the civil aviation sector. There is little room for complacency in this area, despite the boom of air traffic from the late 1990s.

## Introduction

This paper explores the political economy of the policy changes that led to the entrance of private players, and the promotion of competition in the domestic civil aviation industry in India. Domestic civil aviation in India, as a formalised government-owned industry, found its genesis in the Air Corporations Act of 1953. It was enacted by Prime Minister Jawaharlal Nehru's Congress government, in conjunction with the First Five-Year Plan, consistent with the government's aim to promote a closed, self-reliant economy, where the public sector would enjoy the commanding heights. The domestic civil aviation sector has seen remarkable growth from the late 1990s, and has transformed itself from an inefficient government monopoly to a dynamic industry whose growth has been driven by private airlines.

Playing a causal role in this transformation have been several key reform initiatives spearheaded by the Prime Minister's Office (PMO), such as the entry of air taxis, owing largely to the initiatives of Prime Minister Rajiv Gandhi's Prime Minister's Office (1984-1989), to the significant reforms in 1994, and more recent attempts at substantive reform by the National Democratic Alliance (NDA) government (1998-2004). An exploration of the political economy of these reform initiatives reveals a story of how the dual engines of political will to reform within the PMO and the balance of payments crisis of 1991 provided the necessary impetus to reform the inefficient government monopoly. The undeniable role played by entrepreneurial elements in the industry is also evident in the establishment of numerous successful domestic airline corporations.

Powerful political players have opposed the reform initiatives. These include the Ministry of Civil Aviation and the Directorate General of Civil Aviation (DGCA) located within the Ministry, and the nationalised airlines (Air India and Indian Airlines). The conflict of interest between a government that owns airlines and regulates all airlines is a severe impediment to further reform. Furthermore, we find that the ruling party or coalition and its ideology can also shape the pace of reform.

Crisis, to a lesser extent than reform ideas, has been imperative for reform to be enacted into substantive policy and legislation. This is best seen in the crucial reform event of 1994, when the Air Corporations Act of 1953 (which had established the government's monopoly over civil aviation) was repealed. For a government reeling from a balance of payments crisis in 1991, liberalisation and promotion of competition was the only way forward, which translated to broad-based reform in all sectors, including civil aviation. However, the absence of a sector-specific crisis in the civil aviation sector has retarded progress in this sector.<sup>2</sup>

There is no independent regulator in the civil aviation sector. This has produced incompetent regulation reflected in unreasonable taxes on fuels and premium seats, and the continued predatory and anti-private sector orientation of the DGCA. Thus, it is possible that the current turmoil in the civil aviation sector may act as a crisis, if domestic airlines are driven towards bankruptcy as a result of faulty regulation.

This paper concludes by examining the need for an independent and autonomous regulator. While some economists suggest that the civil aviation sector is naturally competitive and that there is no need for an autonomous regulator separate from the DGCA located within the

---

<sup>2</sup> On how sector specific crises propelled reform in the telecommunications sector, see Rahul Mukherji, "Interests, Wireless Technology and Institutional Change: From Government Monopoly to Regulated Competition in Indian Telecommunications," *The Journal of Asian Studies* 68:2, May 2009, pp. 491-517.

Ministry of Civil Aviation, the reality of the political economy of the vested interests involved with this sector suggests otherwise. Additionally, economists posit that the solution to the conflict of interests involved with having two airlines under the jurisdiction of the Ministry of Civil Aviation, and the same Ministry performing the function of a regulator, is the privatisation of these airlines.<sup>3</sup> However, this study of the political economy of the civil aviation sector suggests that such transitions involve politics and legal changes that may be difficult to transact in the absence of an independent regulatory institution.

This paper describes policy changes over four periods in India's aviation history. The first period from 1953 to 1990 witnessed the near monopoly of the government over domestic and international air travel by Indian carriers. The only exception to this rule was the introduction of Air Taxis in 1986. The second period is one from the balance of payments crisis of 1991 to the repeal of the Air Corporations Act (1953) in 1994. Events during this period demonstrate how the combination of political will within the PMO and the balance of payments crisis produce far reaching reforms in the sector. The third period from 1994 to 1999 saw some progress, as a result of the changes initiated in 1994 and gradual reforms beyond that period. The fourth period from 1998 witnessed a serious but failed attempt by the National Democratic Alliance Coalition (1998-2004) to initiate independent regulation in the sector, which could have acted as a precursor for further liberalisation of the sector. The fifth period after 2004 when the United Progressive Alliance has been in power can be seen as a period when discussions about an independent regulator and corporatisation of the nationally-owned airlines have taken a backseat. This does not augur well for the promotion of competition in the civil aviation sector.

### **Period 1: Air Corporation Act of 1953 to the Introduction of Air Taxis in 1986**

Domestic civil aviation in India as a formalised industry was created by the Air Corporations Act of 1953, enacted by Prime Minister Jawaharlal Nehru's government in conjunction with the First Five-Year Plan. The plan articulated the principle that operating airlines would not be economically sustainable for the private sector, and it was the duty of the government to step in and be responsible to the provision of airline services, especially to rural and otherwise inaccessible areas.<sup>4</sup> In keeping with these aims this act merged all existing domestic airlines, with the exception of Air India, into a new public sector corporation called Indian Airlines, which was conferred the monopoly over scheduled domestic flights. Simultaneously, the government converted its option to acquire a majority stake in Air India (in which it previously held a 49 percent stake, with the option of purchasing another two percent), forming Air India International Limited which was granted monopoly over international scheduled operations. Additionally, the 1953 Act instituted a regulatory framework for the formalised civil aviation industry. The Directorate General of Civil Aviation (DGCA) was established under the Ministry of Civil Aviation to perform regulatory functions ranging from issuing pilots' licences to enforcing safety regulations.<sup>5</sup>

Crucial to the foundation of this Act was the absence of a crisis, economic, sector-specific or otherwise. Thus, the direction of policy shaped by the 1953 Act was entirely the product of the political vision and foundational aims of Prime Minister Nehru and his advisers. In keeping with the government's aim of creating a "closed, self-reliant" economy, the aviation

---

<sup>3</sup> Arvind Panagariya, *India: The Emerging Giant*, New Delhi, Oxford University Press, 2008, pp. 400-01.

<sup>4</sup> The First Five-Year Plan accessed at <<http://www.education.nic.in/cd50years/15/8P/82/8P820X02.htm>> on 15 November 2009.

<sup>5</sup> Panagariya, op. cit., pp. 397-398.

policy left control of all aviation assets with the government under the newly-created Ministry of Civil Aviation, as well as under the regulatory purview of the DGCA.<sup>6</sup> Thus, one of the significant legacies of the Nehru era aviation policy is the conflict of interests created when monopoly over civil aviation was granted to the public sector. That regulation and the corporations to be regulated essentially belonged to the same governmental framework has posed a significant threat to the promotion of competition that would come about later. In particular, the collusive behaviour between the DGCA and Indian Airlines after the introduction of private players into the market in 1994, as well as the continued predatory actions of the DGCA, which have lasted into the present, is the manifestation of this close link created between the government and the nationalised carriers as a by-product of the 1953 legislation.

This was the context in which the nationalised civil aviation industry continued to operate for the next few decades. As the tenure of the Indian National Congress continued well into the 1980s, civil aviation policy saw no significant shift in direction. Once again, the absence of any sort of crisis provided little motivation for reform. In addition, the national carriers appeared to be serving the Indian market well. Over this general period, Indian Airlines reported modest profits and, expanded its operations to serve a wide range of cities and states.

The first period of reform of the civil aviation sector occurred when Rajiv Gandhi assumed prime-ministership. His ascendancy to the premiership signalled a marked reorientation in the direction of economic policy. Rajiv Gandhi was trained as a pilot, and prior to entering politics, was employed as a pilot with Indian Airlines. As a child and young adult, Rajiv Gandhi had a strong interest in electronics and flying machines. This continued into his adulthood, and as he entered politics, he was accompanied by a close group of advisers who shared his interest in technology.<sup>7</sup> The PMO under Rajiv Gandhi embarked on reforms to dismantle the industrial controls, as well as modernise public services. The reforms turned out most successfully in the restructuring of the telecommunications industry spearheaded by him.<sup>8</sup> In addition, under his premiership, several government departments were computerised despite strong opposition. Thus, Rajiv Gandhi wasted no time in defining himself as a technocrat.

Civil aviation, with which he bore a personal connection, was one of the sectors in which he brought about reform. In 1986, noting the inefficiencies of Indian Airlines in serving the domestic market, as well as recognising the still relatively small but growing demand for domestic air travel, Prime Minister Rajiv Gandhi sanctioned the entry of non-scheduled air taxi operators into the domestic market.<sup>9</sup> However, this movement towards liberalisation was cautious and the air taxis were only permitted to conduct chartered flights, and were limited to aircrafts having 30 seats or less. Also, they were only approved to fly on certain feeder routes (generally the least profitable routes of Indian Airlines), and this was entirely at the discretion of the DGCA. Opposition to these reforms came from the DGCA which exercised its regulatory controls to impede moves towards privatisation. Such attempts included the

---

<sup>6</sup> On Prime Minister Nehru's rise to pre-eminence and the increasing role of the state in the Indian economy, see Francine R. Frankel, *India's Political Economy: 1947-2004*, New Delhi, Oxford University Press, 2005, pp. 70-77; A. H. Hanson, *The Process of Planning*, London, Oxford University Press, pp. 122-45; and Medha M. Kudaisya, *The Life and Time of G D Birla*, New Delhi, Oxford University Press, pp. 2003: 305.

<sup>7</sup> Dinesh C. Sharma, *The Long Revolution: The Birth and Growth of India's IT Industry*, Noida, Harper Collins India, 2009, pp. 124-73.

<sup>8</sup> Rahul Mukherji, "Managing Competition: Politics and the Building of Independent Regulatory Institutions," in Rahul Mukherji, ed., *India's Economic Transition*, New Delhi, Oxford University Press, 2007, pp 302-04.

<sup>9</sup> Panagariya, op. cit., p. 397.

arbitrary grounding of air taxi operated aircrafts on safety and conduct charges, as well as assigning unprofitable routes to private operators. Hence, the political will and ideas brought to the table by Rajiv Gandhi's PMO had to contend with the vested interests that supported the national carriers. The effect of this reform was thus only nominal. This struggle between political vision and the vested interests of the regulatory bureaucracy has played out in the attempts at reform ever since.

Nevertheless, the PMO continued in its liberalisation, albeit restricted by the pseudo-private framework created to accommodate air taxis, as well as opposition from the DGCA. In 1990, air taxis were allowed to operate aircrafts with up to 70 seats.<sup>10</sup> While the air taxi period of reform did not achieve concrete results in terms of liberalisation, it provided necessary foundations on which subsequent reforms were built. Also, some of the now key private airlines saw their beginnings as air taxis during this period of reform. The successful Jet Airways began its innings around this time. Thus, this period marked the beginning of the reform of the civil aviation sector, and served as a foundation for the further promotion of competition.<sup>11</sup>

Some of the dynamics between players and institutions with interests for and against reform too found their genesis in this period of restructuring. As mentioned before, the DGCA set itself up as the protector of the government's interest, and remained a veritable opponent of reform. The political cost of substantial reform could be quite substantial in the absence of an economic crisis. Thus apart from acting as a foundation for future reform, the air taxi era highlights the key determinants that would come to shape reform into the present.

## **Period 2: The Balance of Payments Crisis of 1991 and Repeal of the Air Corporation Act in 1994**

The next period of reform occurred during and in the immediate aftermath of the balance of payments crisis in 1991. Air taxi operators continued to operate without schedules and under the regulatory eye of the DGCA, which continued its interference in liberalisation and the establishment of new private air taxis. However, the balance of payments crisis of 1991 provided impetus for the liberalisation of the Indian economy. While initial reform occurred in the sector of finance and in industrial and import licensing, this general move towards liberalisation and promotion of competition in areas such as stock market reform, telecommunications de-monopolisation and civil aviation took a longer time. These reforms reflected the vision of then Prime Minister P. V. Narasimha Rao, and then Finance Minister Dr Manmohan Singh, who were empowered by a substantial financial crisis to deal with the vested interests opposed to reforms. Consequently, this political will translated to a drastic reorientation in aviation policy in keeping with the post-crisis economic reforms.<sup>12</sup>

Aviation reform in the post-crisis period crystallised in the Air Corporations (Transfer of Undertakings and Repeal) Act passed in January 1994, which is arguably the most crucial event in the story of liberalisation and promotion of competition in the civil aviation sector. Essentially, this removed government monopoly on domestic scheduled air travel instituted by the 1953 Act.<sup>13</sup> The repeal allowed for the entry of private players (both private Indian

---

<sup>10</sup> "Air Taxi Scheme Eased Further", *Factiva*, 19 March 1990; and Web, 15 November 2009.

<sup>11</sup> Panagariya, op. cit. p. 397.

<sup>12</sup> Rahul Mukherji, "The State, Economic Growth and Development in India", *India Review* 8:1, 2009, pp. 88-96.

<sup>13</sup> Panagariya, op. cit., p. 397.

equity and non-resident Indian equity) into the domestic scheduled market. In addition, a framework was established under the DGCA in order to convert existing air taxi operators into scheduled airlines. The Bureau of Civil Aviation Security was instituted to oversee safety and related matters.<sup>14</sup>

Evidence of the success of this Act in addressing the inefficiencies of the nationalised civil aviation sector that preceded it, can be seen in six airlines which were immediately established.<sup>15</sup> They gained 45 percent of the domestic air travel market within a year. Thus, the Nehruvian era assumption that civil aviation was not an economically viable sector for private players was shattered in one fell swoop by the repeal, which clearly showed the extent of entrepreneurial ability in the domestic market.

However, in other areas of liberalisation, the repeal fell short. Foreign equity was limited to 40 percent of holdings in domestic airlines and the implications of this were later seen in the proposed domestic airline venture between Tata and Singapore Airlines (SIA), which revealed the extent of the conflict of interests between the Ministry of Civil Aviation (as an agent for promoting competition) and Indian Airlines (a holding company under it). The extent of this collusion is also evident in the proposals to raise the foreign equity limit mooted in 1994 (in the wake of the repeal) and later in 1995 and 1997. These proposals were successfully opposed by the Ministry of Civil Aviation, as well as several parliamentary Standing Committees.<sup>16</sup>

In addition, private operators were obliged to devote a fixed percentage of their seat-miles to what were designated as Category 2 and 3 routes, otherwise known as social benefit routes which connected rural and inaccessible areas to the metros. This too proved to be a severe impediment for private airlines that were unable to operate these routes efficiently, with their limited fleet of larger jets purchased to serve major, profitable routes.<sup>17</sup> Once again, Indian Airlines was able to benefit as it was operating inefficiently and unprofitably on these routes due to the cross-subsidisation of these routes by the government. Thus while reform was generally broad-based, few crucial measures that would pose significant hindrance to the promotion of competition were left intact.

The political economy of the repeal in 1994 reveals several factors and agents in favour of the promotion of competition and others in favour of retaining the status quo (that is, anti-competition). It is clear that this reform event was driven largely by two main factors – that of political will and vision, and the crisis that enabled the visionary leaders to successfully oppose the beneficiaries of the status quo. Political will and vision came from the PMO and the Ministry of Finance, both of which had embarked in the direction of substantive reforms of the economy to allow for, and subsequently create a level playing field for private players to enter the Indian economy. The Ministry of Finance was averse to spending taxpayers' precious money in commercially-viable areas. Second, the entry of private carriers could raise resources as a result of the fee that the private players would need to pay in order to

---

<sup>14</sup> The full text of the Act is available at <[http://civilaviation.nic.in/moca/acts\\_rules/GAZETTEpercent20INDIA.pdf](http://civilaviation.nic.in/moca/acts_rules/GAZETTEpercent20INDIA.pdf)> accessed on 15 November 2009.

<sup>15</sup> "Six Companies Granted Scheduled Airline Status", *Factiva*, 15 December 1994; and Web, 15 November 2009.

<sup>16</sup> "Parliamentary committee opposes foreign airlines", *Factiva*, India Business Intelligence, 3 May 1994; and Web, 15 November 2009. Also see "Irreversible? Rubbish", *Factiva*, The Economic Times, 4 April 1997; and Web, 15 November 2009.

<sup>17</sup> "Grounding our Airlines" Livemint.com. *The Wall Street Journal*, 27 April 2009; and Web, 15 November 2009, <<http://www.livemint.com/2009/04/27221805/Grounding-our-airlines.html>>.

obtain a licence. Thus, this general shift in the direction of economic policy translated into an overhaul of the civil aviation sector along these lines.

In comparison with the series of reforms enacted by Prime Minister Rajiv Gandhi, the reforms of 1994 resulted in a far more substantive impact on the sector, and on the economy as a whole. Both reforms emanated due to the political will and a vision for modernisation that the respective PMOs shared. Prime Minister Rajiv Gandhi, who possessed a keen interest in technology and modernisation, translated this interest into a vision for the country. Well-equipped with advisers who shared this common vision, he pushed for reform in several sectors including aviation. While his reforms did play a foundational role for further reorganisation and the promotion of competition by allowing several of the predecessors of the current private players to enter the market as air taxi operators, they still remained quite superficial.

The answer to this lies in the crucial difference in the respective economic environments of these times, that is, the absence of a crisis. While political will and vision are necessary for reform to occur, in a sector with as many vested interests pitted against reform as those in civil aviation, the lack of substantive reform under Prime Minister Rajiv Gandhi suggests that it is not sufficient. However, in the reform of 1994, the balance of payments crisis of 1991 provided impetus to the political will and vision of the PMO and the Ministry of Finance and resulted in broad-based reform of the civil aviation sector. The absence of a sector-specific crisis in civil aviation (the balance of payments crisis did not directly afflict the aviation industry) may have resulted in the attempts at complete liberalisation falling through, and some anti-competitive factors still continuing to haunt the business environment.

Debilitating factors and agents were not absent from the reforms of 1994. These were the ever-present conflict of interest between the DGCA as a regulator; the Ministry of Civil Aviation as an agent for promoting competition and enacting the reforms set forth in the Repeal Act; and Indian Airlines, a player in the domestic aviation market as a holding company under the Ministry; the collusive and often predatory behaviour of these elements; the absence of a sector-specific crisis, and the high burden of taxation.

The DGCA remained steadfast in its defence of the national carriers and opposition to private players, and it fully exploited its vast regulatory powers to crush its competition. The notable regulation was the suspension of aircrafts belonging to Damania Airlines in late 1994 by the DGCA on the charge of drunken behaviour of a passenger during a flight, clearly an arbitrary charge.<sup>18</sup> In addition, evidence suggested collusion between the DGCA and Indian Airlines to crush the competition. The DGCA, using its unrestricted regulatory power, engaged in petty measures to prevent the success of private airlines such as assigning them awkward locations in airports and not allowing interlining (or code-sharing) between these airlines. In the period between 1994 and 1997, Indian Airlines too engaged in its fair share of anti-competitive practices, including the refusal to maintain the planes of private operators despite their offers to pay for maintenance charges at market rates, in United States dollars, which would have much benefitted Indian Airlines in rationalising its excess capacity and subsidising its unprofitable operations. Thus, this begs the question that, despite the passage of the repeal of the Air Corporations Act of 1953, was the government really promoting competition in a transparent manner?

---

<sup>18</sup> “Airlines Privatising the Indian Sky”, *Factiva*, India Business Intelligence. 4 May 1994; and Web, 15 November 2009.



The importance of a sector-specific crisis or in the case of civil aviation, a lack thereof, in creating substantive reform and providing impetus to political will and vision has been discussed. The absence of such a crisis in the civil aviation sector was a contributory factor that favoured the persistence of conflicts of interests present in the regulatory framework of the sector.

The taxation code for the civil aviation sector instituted by this reform too left a lot to be desired in terms of liberalisation and the promotion of competition. This lopsided tax regime best manifests in two areas – taxes on Aviation Turbine Fuel (ATF) and service taxes. ATF faces manifold taxes at various stages. The central government levies an 8.24 percent excise duty on ATF. Furthermore, sales tax is levied on ATF by the individual states under Schedule III of the State Value Added Taxes Act and it ranges between 20 and 33 percent. Added to these are the throughput charges levied by the Airports Authority of India, as well as margins of close to 20 percent levied by suppliers to allay their burden of taxation.<sup>19</sup> As a result, ATF costs for Indian carriers are in the range of 70-95 percent higher than those faced by the carriers in other markets.<sup>20</sup> Not only was the tax regime created by the 1994 reforms debilitating in terms of the promotion of competition, it was in clear violation of the Chicago Convention on International Aviation of 1944, which expressly prohibits taxes on ATF. As a result, the playing field created in the domestic civil aviation market was not level, and was far from the standards governing other national business environments in the area of civil aviation. This was further exacerbated by service taxes instituted on overflight, premium (First and Business Class) tickets, and landing and airport charges, all eating away at the already precarious bottom lines of private players. Once again, these are in violation of the Chicago Convention to which India is a signatory.<sup>21</sup>

These taxes resulted in an imbalance in the aviation playing field in two ways. First, it made the economic viability of private sector carriers extremely tenuous. In a market with many private players and a single public competitor, as that created after the 1994 reforms, the demand for tickets would undoubtedly have been relatively elastic. Thus, the burden of taxation of ATF and service taxes rested squarely on the shoulders of the private providers (in this case on the airlines). This made them unable to pass on the costs to the consumers, making them relatively less competitive than they would have been in a market governed by international standards. On a second level, the imposition of these taxes, while uniform across private and public airlines, came at the clear detriment of the private sector. Indian Airlines, being a Government of India holding, would be able to bear the tax burden without it affecting prices, or their bottom line by virtue of the government being able to cross-subsidise the losses it incurred here with profits made elsewhere, or simply absorb the losses. The private airlines were faced with an economic quandary of having to continue paying exorbitant taxes without having enough market power to raise prices.<sup>22</sup>

The vested interest of the Ministry of Civil Aviation and the DGCA manifested in 1994 in one final way – through the compulsory social benefit routes to which private carriers were required to devote fixed percentages of their capacity (10 percent for Category II and one percent for Category I). While socially laudable, this too had a significant impact in terms of

---

<sup>19</sup> Confederation of Indian Industry (CII), “Taxation Structure in Civil Aviation – A Note”, New Delhi, 2008.

<sup>20</sup> “ATF hike in offing”, *The Economic Times*, Federation of Indian Airlines, 21 November 2007; and Web, 15 November 2009, <<http://www.fiaindia.in/ATF-hike-in-offing.htm>>.

<sup>21</sup> From presentation by Giovanni Bisignani, Director General of the International Air Transport Association to CII, New Delhi, September 2008.

<sup>22</sup> Ibid.

acting as a debilitating factor in the promotion of competition and liberalisation of the civil aviation industry.<sup>23</sup> The most profitable routes for domestic air carriers tended to be those between metros which benefitted from high volumes of passengers. To serve these routes efficiently, private carriers invested in mid-to-large aircraft such as the Boeing 737 (Jet Airways began with four 737s) and the Airbus A320 family of aircrafts. These larger aircrafts, however, were unable to efficiently serve the lower volume, shorter social benefit routes, and private airlines lost significant revenues on these routes.<sup>24</sup> Indian Airlines, once again, was able to absorb these losses. The playing field for private carriers was thus, from its inception, skewed in favour of the nationalised carrier.

Overall, the reforms of 1994 reflected a tussle between the twin engines of crisis and political will, and the factors and agents ranged against it. Ultimately, while a basic level of reform was achieved in that government monopoly came to an end, some of the systemic factors that ran counter to the promotion of competition were not dealt with sufficiently and successfully. The DGCA, which had time and again proved its recalcitrance in dealing with private carriers in a transparent and fair manner, was left largely unchecked, and it continued to wield an inordinate degree of regulatory power, which it used to act against private players at instances when the government players' interests were threatened. It was also evident that significant reform of the tax code was needed for true liberalisation to occur. However, agencies (such as the DGCA), whose pockets were being lined by these taxes, would be a veritable force of opposition. The issue of social benefit routes too highlighted the incompleteness of reform and liberalisation. Foreign equity limitations were also to the overall detriment of the competitiveness of the sector.

### **Intermediary Period: The 1994 Reforms to the NDA Reforms in 1999**

While the 1994 reforms had created a domestic civil aviation sector that was open to private players, significant barriers remained in place. The ensuing period lacked any substantive reform in addressing these barriers. Instead, this period was marred by intrigue, corruption, and predatory and anti-competitive behaviour on the part of institutions that had much to lose with the entrance of private players into the market. The predatory and anti-competitive behaviour occurred on three levels – first, on the level of Indian Airlines acting to protect its interests and market position; second, on the issue of the merger and/or privatisation of Air India and Indian Airlines; and third, by the Ministry of Civil Aviation and the DGCA acting to protect the interests of the national carrier.

Indian Airlines had been severely threatened by the entry of private carriers into what previously had been its exclusive domain. The private airline industry created during the 1994 period of reform had created an internal crisis within Indian Airlines as their pilots and crew were being wooed away by the higher wages offered by private carriers. At the same time, the superior service offered by the private carriers was beginning to take a severe financial toll on its bottom line. In order to protect its interests, Indian Airlines resorted to collusion with the DGCA to put restrictions in place to cripple private competitors. From assigning difficulty to access areas for the check-in counters of private airlines, to refusing to enter into maintenance contracts with smaller airlines that were willing to pay the market rate, Indian Airlines' anti-competitive behaviour was aimed at bolstering its market share at the expense of private carriers. In addition, the DGCA was now more directly involved in

---

<sup>23</sup> "Airlines Privatising the Indian Sky", *Factiva*, India Business Intelligence.

<sup>24</sup> "Grounding our Airlines", *Livemint.com*.

ensuring that private operators flew the mandatory social benefit routes, at times instructing specific airlines to install stopovers on their routes, which undoubtedly hit their already precarious bottom line.<sup>25</sup>

Another solution to the threat posed by private competition in the domestic civil aviation sector was the idea of a merger of Air India and India Airlines. Proponents argued that this would enable the two national carriers to operate more efficiently and benefit from the synergy created in order to streamline their operations. This too prompted harsh criticism from all quarters, including the DGCA, the Ministry and airline workers' unions, due to the fact that redundant routes would have to be rationalised and approximately 7,000 employees would have to be laid off. This allowed both these airlines to continue operating inefficiently, much to the detriment of ailing private carriers. Furthermore, exacerbating this was a report published in 1995 by the Foundation for Aviation and Sustainable Tourism (FAST) recommending an autonomous air transport regulator, citing moral hazard and the DGCA's frequent grounding of private aircrafts and suspension of private airlines.<sup>26</sup>

This intermediary time too was marred by intrigue and corruption in the Ministry of Civil Aviation. The DGCA continued its interference in the private sector. The Minister of Civil Aviation, C. M. Ibrahim, invested himself in opposing any attempts at the promotion of competition. This is best seen in the falling through of a proposed Tata-SIA domestic airline in April 1997, to compete against domestic private carriers as well as Indian Airlines. For this to come through, however, the 40 percent equity limit for foreign investment instituted by the 1994 repeal would have to be increased by parliamentary amendment. The proposal for the new airlines was hailed by the Foreign Investment Promotion Board, as well as industrial bodies such as the Federation of Indian Chambers of Commerce and Industry and the Confederation of Indian Industry (CII), as a step forward in expanding consumer choice and helping to infuse a somewhat ailing industry with a new dynamism and liquidity.<sup>27</sup>

The Tata-SIA venture, however, came under sharp opposition both from the parliament (a standing committee unanimously rejected its proposal) and the Ministry. Minister Ibrahim's direct involvement in the rejection of this venture was seen in the speeches he delivered to parliament decrying the venture as a threat to the national carriers, as well as comments made at press conferences in which he suggested that this venture would compromise India's national interest.<sup>28</sup> Evidently, promoting competition was secondary to the financial well being of the national carriers. Further, he swiftly shot down renewed calls to merge and privatise Indian Airlines and Air India. Ibrahim, thus, established himself as an enemy of reform and liberalisation in the civil aviation sector, and as a protector of the national carriers.<sup>29</sup>

Some progress was made in the civil aviation sector, despite the Tata-SIA debacle in 1997. The regulatory changes helped the domestic airline industry flourish from the late 1990s. First, the barriers to entry and exit of airlines were removed. Second, private airlines could

---

<sup>25</sup> "Airlines Privatising the Indian Sky", *Factiva*, India Business Intelligence.

<sup>26</sup> The FAST is a non-governmental organisation founded in 1992 with the aim of promoting civil aviation and tourism in harmony with the environment ([www.fastindia.org](http://www.fastindia.org)).

<sup>27</sup> "India Prohibits Investment by Foreign Airlines", *Factiva*, *Financial Times*, 3 April 1997; and Web, 15 November 2009.

<sup>28</sup> "Cabinet rules out Tata-SIA airline project", *Factiva*, *The Times of India*, 4 April 1997; and Web, 15 November 2009.

<sup>29</sup> "Kaw asked to review AI-IA merger issue", *Factiva*, *The Hindu Business Line*, 2 June 1997; and Web, 15 November 2009.

now fly aircrafts with over 50 seats. Third, private carriers were allowed to choose the size and type of aircraft for the first time. Fourth, Non-Resident Indians could now invest up to 100 percent in the equity of an Indian airline.<sup>30</sup> These changes were critical complements to the liberalisation that was initiated in 1994.

The ‘two-step forward, one-step backward’ approach to economic reforms continued in the intermediary period. The reforms of 1991 were critical. Yet, the Tata-SIA debacle was a prime illustration of the political economy of aviation reform in this intermediary period. Without a leader having political will or vision, and further with a minister, a regulatory body, and two nationalised carriers firmly set against reform, it was inevitable that the pace of reform would be affected. Furthermore, in the absence of a crisis (national or industry specific) – the imperative that had catalysed the political will that resulted in the 1994 reforms – there was little incentive for the government to pursue more radical reform. Private airlines were surviving on the entrepreneurial skills and business acumen of their managers and an ever-growing market. Thus it is clear that the sector was in need of either a reinvigoration of political will and vision (that resulted in the reforms during Prime Minister Rajiv Gandhi’s time), a crisis of some magnitude (that resulted in the 1994 reforms) or some combination of both to provide impetus for reform. The regime change in the 1998 general election, from which the centre-right coalition, the NDA, emerged victorious, heralded the entrance of fresh political vision, but would reform follow?

### **Period 3: The NDA Reforms from 1999 to 2004**

The NDA was elected to power in the 1999 General Election on a platform of liberalising the domestic Indian economy, and disinvesting government-held companies. The political will and vision of the new Prime Minister Atal Behari Vajpayee was, thus, in this direction of economic deregulation.<sup>31</sup> Having inherited a civil aviation sector that was ailing from the systemic inefficiencies of the national carriers and an uneven playing field for the private carriers, the new minister, Rajiv Pratap Rudy proposed swift reforms, including the privatisation of Air India and Indian Airlines, mirroring the NDA government’s platform.<sup>32</sup> Once again, in the absence of a crisis, political will was a necessary but insufficient factor in pushing through reform. Vested interests from the DGCA and the national carriers (whose bureaucrats had much to lose from privatisation or merger) once again rendered these attempts futile. Nevertheless, Prime Minister Vajpayee’s PMO, with the active support of the ministry, continued down the path of liberalisation.

After the failed attempt at ad hoc reform by Rudy in 2000, Vajpayee’s PMO commissioned the Naresh Chandra Committee to look into the aviation sector, identify its systemic problems, and accordingly propose policy reforms.<sup>33</sup> The Vajpayee PMO, thus, it appeared, did not want to extinguish its political will and ideas by tilting to the ‘windmills’ of vested interest groups like the DGCA. The Naresh Chandra Committee’s recommendations would, therefore, provide a roadmap for systematic reform, and would also lend this reform

---

<sup>30</sup> Panagariya, op. cit., p. 398.

<sup>31</sup> Baldev Raj Nayar, “The Limits of Economic Nationalism in India: Economic Reforms under the BJP-led Government.” in Rahul Mukherji, ed., *India’s Economic Transition*, New Delhi, Oxford University Press, 2007, pp. 202-25.

<sup>32</sup> “Modernising airports among Rudy’s priorities”, *Factiva, The Hindu*, 15 June 2003; and Web, 15 November 2009.

<sup>33</sup> “Naresh Chandra to head panel on civil aviation roadmap”, *Factiva, The Hindu Business Line*, 17 July 2003; and Web, 15 November 2009.

legitimacy as the panel itself was nonpartisan and composed of eminent political figures and business people.

The committee was convened and consisted of the eponymous chair, Naresh Chandra, former Cabinet Secretary and former Ambassador of India to the United States,<sup>34</sup> Chairman of Housing Development Finance Corporation Limited, Deepak Parekh, Advisor to the Planning Commission, Dr Pronab Sen, Secretary at the Ministry of Civil Aviation, Mr. K. Roy Paul, and Additional Secretary and Financial Adviser at the Ministry of Civil Aviation, Mr. V. Subramanian. Having studied airport and air traffic data, as well as having interviewed parties, both public and private involved in the civil aviation sector, the Naresh Chandra Committee published its roadmap for civil aviation reform in November 2003 recommending drastic reforms for the civil aviation sector.

Some of the measures proposed included raising the foreign equity limit in domestic airlines from 40 percent to 49 percent, as well as disinvesting the two national airlines. It also recommended the creation of an autonomous Aviation Economic Regulatory Authority (AERA) to address what it viewed as the inherent conflict of interest with having the DGCA as a regulator in the civil aviation sector. Other recommendations included the removal of various archaic taxes in place in the civil aviation sector, for example, excise duty, central sales tax, as well as the removal of restrictions on the travel of government employees by private carriers. The regulations on third-party ground handling services were also to be removed as per the report.<sup>35</sup> Overall, the aim of reform suggested by the Naresh Chandra Committee report was that of privatisation and disinvestment, complete liberalisation, autonomous regulation and the creation of a level playing field.

Thus, it was clear that the Naresh Chandra Committee was recommending further reform in the direction embarked upon by Vajpayee and Rudy.<sup>36</sup> It aimed to give legitimacy to its reform initiatives and gain reinforcement for its vision from the report. Vajpayee and Rudy swiftly began assembling these recommendations into policy to be put to vote in parliament by January 2004. The PMO also became heavily involved in the disinvestment of government assets in civil aviation and assigned the disinvestment of the national carriers as a key objective to the newly appointed Disinvestment Minister Arun Shourie. Sharad Yadav, initially appointed as Minister of State for Civil Aviation, was removed and replaced by Shahnawaz Hussain, due to the former's opposition to the disinvestment of the national carriers.<sup>37</sup> It was clear that the political vision of the PMO in reforming the civil aviation sector was primary and opposition from within would be contested.

Significant opposition to the broad based reforms embarked upon by the NDA government came from allied parties such as the Dravida Munnetra Kazhagam and Trinamool Congress, as well as the DGCA, which prevented the progress of disinvestment. However, in other areas, significant reform was achieved. Noting the excessive tax burden on private carriers, central excise duty on ATF was reduced from 16 percent to eight percent. Landing charges

---

<sup>34</sup> "International Crisis Group – Naresh Chandra", International Crisis Group – Conflict prevention and resolution, Web, 14 November 2009, <<http://www.crisisgroup.org/home/index.cfm?id=4224>>.

<sup>35</sup> "Give foreign airlines 49 percent stake" – Naresh Chandra panel moots opening up aviation sector", *The Hindu Business Line*, *The Hindu*, 8 December 2003; and Web, 15 November 2009. <<http://www.blonnet.com/2003/12/09/stories/2003120902310100.htm>>.

<sup>36</sup> The full text of the report is available at <<http://civilaviation.nic.in/moca/nccommittereport.pdf>>.

<sup>37</sup> "Cabinet reshuffle: NDA allies lose key portfolios", India News Online, *Indiamart*, 3 September 2001; and Web, 15 November 2009, <<http://news.indiamart.com/news-analysis/cabinet-reshuffle-nd-5203.html>>.

were rationalised and brought up to par with international standards and conventions. Furthermore, the Inland Air Travel Tax and Foreign Travel Tax were scrapped, and the launch of low cost airlines (such as Air Deccan) was supported. Thus, the political will and vision of the NDA government, catalysed by the ‘stamp’ of legitimacy and backing from the Naresh Chandra Report, was able to achieve substantive reform in levelling the aviation playing field.

However, in two key areas of recommendation by the Naresh Chandra Committee, the NDA government failed in pushing through reform – first, in the privatisation of the national carriers; and second, in the creation of an autonomous regulator. Why then was political will and vision, given legitimacy by the report, unable to see these reforms through? The answer lies in the complex network of vested interests which entangle the national carriers and the DGCA, both of which would have had a lot to lose from the passage of such reforms.

The privatisation of Indian Airlines and Air India has long been a tenuous issue in the reform of the civil aviation sector. Each employing approximately 25,000 employees, with seven trade unions representing just the workers of Indian Airlines, it is clear that reform would take immense political will. Furthermore, exacerbating this, Indian Airlines and Air India at that point in time were financially sound. Having responded more constructively to competition from private players, Indian Airlines had cut costs and streamlined its operations to yield a Rs. 44 crore profit for the year ending March 2004.<sup>38</sup> Thus, there was no internal financial crisis that would provide impetus for disinvestment. Externally, too, the Indian economy was faring well with 8.5 percent growth for the year ending March 2004.<sup>39</sup> Thus, there was no external crisis to provide imperative reasons for reform such as the balance of payments crisis did in 1991. Thus, the vested interests were able to hold out long enough until democracy played out its natural course and the NDA lost power in the 2004 General Elections due to anti-incumbency and a perceived failure in bringing proportional growth to the rural areas as had been brought to the cities.<sup>40</sup>

The issue of an autonomous regulator naturally drew the ire of the DGCA which had, since 1953, been enjoying complete regulatory control over the domestic civil aviation sector. Strong political will and legitimacy granted by the Naresh Chandra Committee report was simply insufficient in countering the vehement opposition of the DGCA, the bureaucratic framework it had established close links with in the Ministry of Civil Aviation, and the national carriers. The absence of a crisis too was unhelpful for attempts at such substantial reform.

Another factor to be considered in the failure of the NDA government in passing reforms in these two key areas is that of timescale. The Naresh Chandra Committee report was published only in November 2003 and General Elections were due in July of 2004. This gave the NDA government, which had to focus its priorities on electoral prospects as well, a very small time frame to enact incredibly complex and far-reaching legislation. Added to this were

---

<sup>38</sup> “Indian Airlines: profitable after four years”, Domain-b.com: The first online Indian business magazine, 8 December 2004; and Web, 15 November 2009, <[http://www.domain-b.com/companies/companies\\_i/indian\\_airlines/20041208\\_profitable.htm](http://www.domain-b.com/companies/companies_i/indian_airlines/20041208_profitable.htm)>.

<sup>39</sup> Confederation of Asia-Pacific Chambers of Commerce and Industry Country Report on India, accessed at <<http://www.cacci.org.tw/Journal/2004percent20Volpercent202/CountryReport-India.pdf>> on 15 November 2009.

<sup>40</sup> Steven I. Wilkinson, “Elections in India: Behind the Congress Comeback”, *Journal of Democracy* 16:1, 2005, pp. 155-165.

the various vested interests involved in these issues. Thus, given the timescale of reform and an election looming, substantive reform in areas as complex and sensitive as these could not be sustained by the political will of the NDA government.

#### **Period 4: Post-NDA era from 2004 to the Present**

With the electoral victory in the 2004 General Elections, the centre-left United Progressive Alliance (UPA) coalition came to power. With this transition into the UPA government, aviation reform took a self-confessed “backseat”. Praful Patel, the Minister of Civil Aviation, and the central government made it unequivocal that their position on Air India and Indian Airlines was not one of disinvestment, but of “nurturing” under government control. This clear shift reveals yet another variable to be considered in the story of the political economy of civil aviation – that of the importance of the positioning and direction of policy of the ruling coalition or party.

While the platform of the NDA coalition was clearly one of economic liberalisation and disinvesting government assets, with the regime change came about a change in policy direction and orientation. The UPA government was focused on creating representative growth that would bring as much benefit to the rural areas as it did to the urban side. Aviation policy, too, was faced with a marked re-orientation. From actively pursuing reform as per the Naresh Chandra Committee Report as recommended by the outgoing NDA government, the UPA government took a more cautious stance towards outright reform. On the question of foreign equity in domestic airlines at a time when liquidity was becoming a major concern for private operators, Patel articulated this stance by claiming in November 2004 that the “time was not ripe yet”.<sup>41</sup> Thus, the position of the ruling party or coalition was, to a large degree, crucial in determining the pace of reform.

The most significant reform event of the UPA tenure thus far has been the merger of Indian Airlines and Air India. However, this was operationally insignificant as the merger was unable to create any synergy. Also, it resulted in expanding losses for both, due to the incompatibility of operations and management of the two airlines. In Financial Year 2007 alone, Indian Airlines reported a Rs. 2.4 billion (SGD 72 million) loss, which doubled in the following financial year. The government, itself reeling from the global economic slowdown, and faced with a ballooning budget deficit, can only hold out for Indian Airlines and Air India for so long. A crisis is imminent for the nationalised carrier, and hopefully it will catalyse some latent political will and translate into serious reform of the national carrier.

While no other major reforms have come through, anti-competitive elements, both intrinsic and extrinsic to the government, continue to beleaguer the private domestic carriers. The anti-competitive and anti-private sector role of the DGCA continues to be seen in the recent ban instituted on the trading of seat-miles by private airlines. In response to the inefficiency of having to operate both major, profitable routes and unprofitable social benefit routes, private carriers began trading seat-miles on these social benefit routes to smaller regional airlines. Thus the larger private carriers would carry passengers of the regional airlines on major routes, which they operated more profitably with larger aircraft, and the regional airlines would carry passengers of the larger private airlines on the social benefit routes which they were able to operate more efficiently with smaller, lighter aircrafts. The DGCA, however, did

---

<sup>41</sup> “Naresh Chandra report clears civil aviation policy path”, *Indianexpress.com*. *Indian Express*, 3 November 2004; and Web, 15 November 2009, <<http://www.indianexpress.com/oldStory/58202/>>.

not view this as favourably and forced all carriers to fly their compulsory social benefit routes, despite strong opposition from the airline lobby, the Federation of Indian Airlines. In particular, the timing of the decision in July 2009 was criticised, as airlines are still reeling from the effects of the global recession.<sup>42</sup> Once again, the spectre of anti-competitive behaviour, which characterised the industry in the late 1990s, was resurrected by the DGCA.

Another intrinsic factor that has debilitated the promotion of competition has been the tax code. Despite attempts at reform by the NDA government, the tax burden faced by airlines in India far surpasses international standards. Taxes such as service tax on premium seats, for example, continue to be in violation of international conventions on aviation (this tax, in particular, violates the International Civil Aviation Organization Council Resolution 8632 of 2000). This excessive tax burden has ended up with absurd situations such as how, on average, one kilogram of ATF can cost Rs. 73,600 in Mumbai, as compared to Rs. 46,500 in Singapore.<sup>43</sup> Coupled with one of the worst recessions the global economy has seen in over a century, rising costs have spelt disaster for the Indian domestic aviation industry. Thus, in the summer of 2009, a consortium of private Indian carriers, under the lobby group – the Federation of Indian Airlines, demanded a bailout as the carriers would be unable to continue operating with these excessive costs. While the threat of strike by private carriers scheduled for 18 August 2009 has been quelled for now,<sup>44</sup> the cost issue is one that needs to be urgently dealt with, and is one of the key problem areas identified by the CII as being crucial for the future of the aviation industry.

Thus, cost management, coupled with the demand-side effects of a global economic slowdown, are the key problems facing both private and public players in the civil aviation industry. While this has manifested as a crisis of sorts in the public sector (with Air India needing to undergo massive restructuring) due to the poor general fiscal health of the national carriers, a crisis has yet to strike the private airlines. The entrepreneurial abilities and business acumen of the chiefs of private airlines, including Naresh Goyal of Jet and Vijay Mallya of Kingfisher, have seen their businesses grow from small air taxi operators to national players with significant market shares (in the first months of 2009, for example, Jet held a 17.9 percent market share and Kingfisher 27.6 percent).<sup>45</sup> They have adopted the best practices from global leaders such as SIA and have brought about industry-wide improvements in on-time records and in-flight service standards. Despite having to struggle against a crippling tax system and intervention from various branches of the government, they continue to maintain their social obligations. All private airlines continue to survive and some private airlines have managed to remain profitable.<sup>46</sup>

However, the recent demands for a bailout and threats of a private airline strike speak to the possibility of the civil aviation sector (already under much financial duress) being hit by a calamitous financial crisis. It is fair to say with a reasonable degree of conjecture that such a crisis may just provide the much needed impetus for the UPA government to reform the remaining lapses and restrictions in place that are crippling the promotion of competition.

---

<sup>42</sup> Tarun Shukla, “Regulator bars airlines from skipping unprofitable routes”, *Livemint.com. The Wall Street Journal*, 24 April 2009; and Web, 15 November 2009, <<http://www.livemint.com/2009/04/24000913/Regulator-bars-airlines-from-s.html>>.

<sup>43</sup> From presentation by Giovanni Bisignani to CII, New Delhi, September 2008.

<sup>44</sup> V. Manju, “Airlines strike may not take off”, *The Times of India*, 2 August 2009; and Web, 15 November 2009, <<http://timesofindia.indiatimes.com/NEWS/Business/India-Business/Airlines-strike-may-not-take-off/articleshow/4846690.cms>>.

<sup>45</sup> Calculated from the Ministry of Civil Aviation’s figures.

<sup>46</sup> SpiceJet press release from <<http://www.spicejet.com/newspage.asp?strNews=Q1FY010>>.



However, the back and forth dialogue between Minister Patel and airline chiefs suggest that other variables may be in play. Regardless, it is clear that some form of reform or bailout will be needed for the aviation sector to continue operations, and taking into consideration the widening deficit, reform may well be a more viable and sustainable option.

### **Conclusion: Is there a need for an Independent Regulator?**

Overall, the exploration of the political economy of the four periods in the history of the domestic civil aviation sector reveals that reformers have to contend with a powerful opposition. There has been an interplay of several variables, both intrinsic and extrinsic, that has shaped the civil aviation sector into what it is today. First, a crisis played a significant, catalysing role in bringing about substantive reform. This can be seen in the circumstances surrounding the 1994 Repeal Act. Similarly, the absence of a crisis allowed vested interests to thwart the NDA government's attempts at reform of the sector.

Second, the combination of political will and crisis were critical for deregulating the civil aviation sector in India. During Prime Minister Rajiv Gandhi's time, a technologically-inclined PMO concerned with efficiency considerations was able to work against elements within the Ministry of Civil Aviation and the DGCA to bring about the first clear reform in the aviation sector since independence. These reforms were significant because of the change in direction in which they signalled, even though substantial deregulation could not be achieved in the absence of a crisis in the 1980s. The substantial reforms of 1994 were propelled by a pro-deregulation vision, which was politically empowered by the balance of payments crisis of 1991. Despite this, we demonstrated how anti-competitive elements within the Ministry of Civil Aviation and the DGCA continued to thwart the pace of reform. In the NDA government's attempts at reform based on the recommendations set forth in the Naresh Chandra Committee report (2003), political opposition from the DGCA, the national carriers and their unions, and the alliance partners of the Bharatiya Janata Party, severely constrained the pace of reform, despite the best intentions of Prime Minister Vajpayee.

Third, the importance of the ruling coalition or party, and its ideology, is important in shaping the direction of policy. While the centre-right NDA wished to liberalise, disinvest and promote competition as per its platform of supply-side economics, the UPA, a centre-left coalition, was more cautious in its approach to liberalisation as it advocated a more representative, government-centric economic policy.

Fourth, we come to the defining factor of the Indian civil aviation story, namely, that of the government's conflict of interests between a regulator (DGCA) located within the Ministry of Civil Aviation and the interest of private players. How can the Ministry regulate a market in which it held stakes in two significant players? How can the government promote competition against its own corporations? This conflict of interest has played itself out with pro-reform ministers (Rudy) and anti-reform ministers (Ibrahim), without significant movement in the direction favouring independent regulation. Thus, this begs the question that, as per the Naresh Chandra Committee report, is there a need for an independent regulator in place of the DGCA?

The Naresh Chandra Committee report has argued for an autonomous regulator called the AERA in order to address the "inherent conflict of interest" in having the government as the regulator and a player in the industry. Contrary to this, some economists have suggested that the DGCA could continue as the regulator, and the conflict of interest be dealt with by

privatising the national carriers. The naturally competitive nature of the industry would in fact be hampered by the red tape involved in setting up a new regulatory framework.<sup>47</sup> However, this study suggests otherwise mainly for two reasons – first, the enormity and inherent difficulty of the task of privatising airlines, and second, whether this is necessary in the first place.

The impracticality of the privatisation of Air India and Indian Airlines has resulted in this proposition being turned down several times when it has been brought up in national political discourse. The sheer scale of operations, both possessing a combined total of more than 50,000 employees, as well as the frameworks already in place, including unions and pensions, may pose more difficulties than what meets the eye. Furthermore, is there a real need to privatise these airlines? While there is a general consensus that drastic improvements need to be made in terms of in-flight service and the state of aircrafts for the national carriers to remain competitive, does this necessitate privatisation? Corporatisation under government control is a viable option, in that Air India and Indian Airlines would continue to be held under the government but would operate as private corporations (decisions being made by hired managers and executives, not bureaucrats). This would entail financial accountability to its shareholders (here the government), the autonomy of executive decisions, as well as the ease of hiring and firing that comes with privatisation. Prime examples of airlines operating under this model include SIA, Emirates Airline and Qatar Airways, all three of which have come to exemplify excellence in service and coverage. One only has to look back a few decades in history to analyse Air India that had a stellar reputation in the 1960s and 1970s. The government too has a strategic interest in maintaining ultimate control in its national carriers, and thus contrary to conventional economic wisdom, privatisation of the national carriers may not be the best solution to the conflict of interest. Moreover, the reform of government-owned telecom operators and the Indian Railways mentioned above, suggests that reform should be possible in the case of Air India, if substantial political resources could be expended towards this effort.

The DGCA is an organisation inexorably intertwined with the civil aviation industry. Thus, it is hard to tell whether, upon the privatisation of the national carriers, the same bureaucrats in charge of regulating the civil aviation sector who have until now shown a clear tendency for anti-competitive behaviour, would suddenly become impartial and independent. The nature of the vested interests is such that it would be very hard for the DGCA, with its history of ‘predatory behaviour’, to become independent and autonomous. Thus, a regulator like the proposed AERA would be able to start from scratch with a team of independent, non-partisan officials staffing it, and do a much more fair and thorough job of regulation without all the ‘baggage’ that comes with the DGCA. Once again, by holding the AERA accountable to the government, a further set of checks and balances is added. Thus, a corporatised Air India-Indian Airlines, an independent and autonomous regulator, and a level playing field for private carriers free of excessive taxes and in accordance with international conventions, will certainly spell a bright future for the civil aviation sector.

oooOOOooo

---

<sup>47</sup> Panagariya, op. cit., p. 401.