AIR TRANSPORT DEREGULATION IN INDIA: A COMPARATIVE AND CRITICAL ANALYSIS WITH THE US

Tamoghna Agasti

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Institute of Air and Space Law, Faculty of Law
McGill University
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McGill

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ABSTRACT

The global aviation industry has significantly progressed, forcing air carriers and regulators to evolve by adapting policies to foster the growth and development. While traditional rules on air safety and infrastructural regulations remain, the removal of economic regulations or deregulation has become the norm. It is true that deregulation and liberalisation started in the west with the United States (US) taking the lead, but it has created a global trend towards it, and all countries have adapted its practices to various degrees. However, mindless deregulation by simply following the trend without taking into consideration the peculiar developmental needs of the country can have a detrimental impact.

Deregulation of air transportation began in India as well, nevertheless, its pace and extent are significantly lower compared to its western counterparts. Unlike the US, the government in India lacked the opportunity for thorough studies prior to deregulation. The driving factors for deregulation in India have been the government's failure to cope with the increased demand for air travel, the poor performance of carriers and a reaction to international trends. While the US has completely deregulated its airline industry, India has a semi-regulated one and, to date, continues to liberalise the sector gradually.

The thesis is a comparative study of the deregulation experiences in India and the US. The paper examines whether India can learn lessons from the deregulation experience of the US in its journey of liberation. Specific circumstances need to be considered, such as the developmental needs of India, the size of the market, connectivity to remote parts and governmental support that differentiate the Indian market from the US. Taking into consideration all these factors, the thesis critically evaluates India's aviation policies in light of the wave towards liberalisation. It involves extensive discussion on the theories of regulation and deregulation, the US experience of deregulation, the history of India's aviation industry, the motivating factors for India to deregulate the industry and its journey and experience of deregulation. Detailed critical and comparative analysis of the policies that shape the industry today is undertaken. Conclusions are drawn about the relevance of the US experience for airline deregulation in India with the aim of providing policy recommendations to aid in India's continuing journey of liberalising the air transport industry.

RÉSUMÉ

L'industrie mondiale de l'aviation a considérablement progressé, menant les transporteurs aériens ainsi que les législateurs à évoluer en adaptant les politiques pour favoriser la croissance et le développement. En effet, si les règles traditionnelles en matière de sécurité aérienne et d'infrastructures demeurent, la suppression des réglementations économiques, ou « déréglementation », est devenue la norme. Celle-ci a pris naissance en Occident, d'abord aux États-Unis qui ont, par la suite, influencé les autres pays à adapter leurs pratiques à des degrés divers. Or, une déréglementation irréfléchie, suivant simplement la tendance mondiale sans prendre en considération les besoins de développement particuliers de chaque pays, peut avoir un impact négatif.

La déréglementation du transport aérien a déjà débuté en Inde, bien que son rythme et son ampleur soient nettement inférieurs à ceux de ses homologues occidentaux. Contrairement aux États-Unis, le gouvernement indien n'a pas eu l'opportunité de réaliser des études approfondies avant de débuter la déréglementation. Mais, l'Inde a dû déréglementer pour faire face à l'augmentation de la demande de transport aérien, aux mauvaises performances des transporteurs ainsi qu'en réaction aux tendances internationales. Contrairement aux États-Unis qui ont une industrie totalement déréglementée, l'Inde a, à ce jour, une industrie semi-réglementée et continue de libéraliser le secteur progressivement.

Dans ce mémoire, est réalisée une étude comparative des expériences de déréglementation en Inde et aux États-Unis. Cette étude vise à déterminer si l'Inde peut tirer des leçons des expériences de déréglementation des États-Unis. À noter que des circonstances spécifiques à l'Inde, qui la distingue des États-Unis, doivent être prises en compte, telles que les besoins de développement du pays, la taille de son marché, l'accès à ses régions éloignées ainsi que le soutien apporté par le gouvernement. En prenant en considération tous ces facteurs, ce mémoire évalue donc de manière critique les politiques aéronautiques de l'Inde à la lumière de cette tendance mondiale vers la libéralisation. Il comprend plus spécifiquement une discussion approfondie sur les théories de la réglementation et de la déréglementation, l'expérience américaine de la déréglementation, l'histoire de l'industrie de l'aviation indienne, les facteurs motivant l'Inde à déréglementer l'industrie et, finalement son expérience en matière de déréglementation. Une analyse critique et comparative détaillée des politiques qui façonnent l'industrie aujourd'hui est donc entreprise. Finalement, des conclusions sont tirées sur la pertinence pour l'Inde de l'expérience américaine en matière de déréglementation du transport aérien, dans le but de fournir des recommandations politiques pour aider l'Inde à continuer de libéraliser l'industrie du transport aérien.

LIST OF CHARTS

LIST OF ACRONYMS AND ABBREVIATIONS

0/20 Rule – No minimum experience is required to fly on International routes as long as carriers deploy twenty aircraft or twenty per cent of their total capacity on domestic routes (India)

5/20 Rule – Minimum five years of experience in the domestic market and minimum of twenty aircraft in the fleet required to fly on international routes (India)

AAI – Airport Authority of India

ADA - The Airline Deregulation Act, 1978 (US)

AOP – Air Operator Permit

ASA – Air Service Agreement

ASEAN - Association of Southeast Asian Nation

ASK – Available Seat Kilometre

ATF – Aviation Turbine Fuel

BELF – Break Even Load Factor

CAA - Civil Aviation Authority (UK)

CAB - Civil Aeronautics Board (US)

CCI – Competition Commission of India

CEO – Chief Executive Officer

CRS – Computer Reservation System

DGCA – Directorate General of Civil Aviation (India)

DOJ – Department of Justice (US)

DOT – Department of Transportation (US)

EAS – Essential Air Service (US)

FAA - Federal Aviation Act, 1958 (US)

FDI – Foreign Direct Investment

FSC – Full-Service Carrier

HHI – Herfindahl Hirschman index

IASTA – International Air Service Transit Agreement

IATA - International Air Transport Association

IATCA - The International Air Transportation Competition Act of 1979 (US)

ICAO – International Civil Aviation Organization

INA - Indian National Airway (Indian Airline)

KLM - Koninklijke Luchtvaart Maatschappij (Dutch Airline)

LCC – Low-Cost Carrier

LoA – Letter of Award

NCAP – National Civil Aviation Policy, 2016 (India)

NOC – No Objection Certificate

PLF – Passenger Load Factor

RCF – Regional Connectivity Fund

RCS – Regional Connectivity Scheme (India)

RDG – Route Dispersal Guidelines (India)

RPK - Revenue Passenger Kilometre

Rs – Indian Rupees

SAARC - South Asian Association for Regional Cooperation

SAO - Selected Airlines Operator

SIFL - Standard Industry Fare Levels

TWA - Trans World Airlines (US Airline)

UAE – United Arab Emirates

UK – United Kingdom

US – United States of America

USD – United States Dollar

VAT – Value Added Tax (India)

VGF – Viability Gap Funding

INTRODUCTION

1. Context of Study

Prior to the 1920s, governments in most countries adopted a non-interventionist approach to the transportation sector including air transportation and the market was left to operate unfettered.[1] During the 1920-30s when air transport was gradually becoming a normal means of travel, there was a prevailing view that the government ought to control the industry to enable its growth and prevent destructive competition.[2] The view was that air transport is a public utility and it is in the interest of the public that the government must control it.[3] Soon governments of all persuasions assumed close control over the provision of airline services either through strict regulations for the operations of private carriers or by granting a monopoly to the government carrier thereby closing the door for private participation.[4]

It was not until the 1970s that academicians and aviation specialists began voicing their opinion that economic regulations on air carriers were no longer necessary and desirable[5] as it fosters inefficiencies within the industry. Regulation of the airlines was judged to be inimical to the interests of the public it was supposed to be protecting.[6] These arguments were persuasive enough and the breakthrough happened in 1978 in the US with the introduction of the Airline Deregulation Act 1978[7] which completely liberalised the domestic aviation market. This triggered a chain of reactions throughout the world and several developed countries like New Zealand, the United Kingdom, Australia, and Canada went down the path of liberalisation in the next two decades.[8] The US went a step ahead and introduced the international open skies policy in an attempt to liberalise international air transportation with like-minded countries.[9] It negotiated liberal Air Service Agreements (ASA) designed to trade 'liberalization for liberalization in place of restriction for restriction'.[10] Through the open skies agreements, most restrictions on price, capacity, designations, and routes were removed and set to be determined

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[1] Kenneth Button, "The Deregulation of U.S. Interstate Aviation: An Assessment Of Causes And Consequences (Part 1)" (1989) 9:2 Transport Rev 99 at 99.
[2] Paul Hooper, Simon Hutcheson & Michael Nyathi, "The Challenge Of Liberalising Domestic Airline Competition in a Less Developed Country" (1996) 23 Transportation 395 at 395.
[3] Button, *supra* note 1 at 99-100.
[4] Hooper, Hutcheson & Nyathi, *supra* note 2 at 395.
[5] Michael E Levine, "Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy" (1987) 4 Yale J Reg 393 at 394.
[6] Hooper, Hutcheson & Nyathi, *supra* note 2 at 396.
[7] *Airline Deregulation Act,* Pub. L. No. 95-504, 92 Stat. 1705 (1978) (codified as amended in various scattered sections at 49 U.S.C.) (US) [*ADA*].
[8] Hooper, Hutcheson & Nyathi, *supra* note 2 at 396.
[9] Paul Stephen Dempsey, *Public International Air Law* 2nd ed (Montreal: McGill University, Centre for Research in Air and Space Law, 2017) at 668-69 [Dempsey, *Public Air Law*].
[10] Rigas Doganis, *Flying Off Course: The Economics of International Airlines* (New York: Routledge, 1992) at 53.

by market forces.[11] The US adopted an encirclement tactic wherein it first entered into liberal agreements with smaller countries which inevitably created market pressure to lure more resistant larger countries.[12] This tactic was successful and today the US has open skies agreements with more than one hundred and thirty countries[13] along with a completely liberalised domestic market.

Air transport liberalisation has robust impacts. Liberalisation has the potential of increasing air traffic, reducing fares, transforming the industry, and supporting the socio-economic development of the country.[14] It changes the competitive atmosphere in the industry by reducing entry and exit barriers and restrictions on the operations of air carriers.[15] This lures the entry of multiple players and carriers are forced to adopt innovative business strategies to survive in the competitive market bringing in overall efficiency within the industry. Liberalisation enables carriers to expand their services to new destinations and capture new passengers thereby generating higher revenue. Without regulation on fares, commercial carriers apply better price mechanisms, optimise their operations and adopt new business models to attract customers to survive in the free market.[16] Moreover, ease of entry allows different types of carriers to commence operations like Full-Service Carriers (FSC), Low-Cost Carriers (LCC), and regional carriers among others which not only provide customers with a range of choices but also enhances connectivity even on less dense regional routes.[17] In other words, airlines are offered more freedom to develop their market strategies that best suits them to maximize their efficiencies and profits. Carriers that fail to operate efficiently are thrown out of the market.[18]

There is no doubt that liberalisation can bring immense benefits but there are substantial risks associated with it as well, especially for developing countries.[19] Liberalisation, if not done soundly can lead to multiple market failures leading to consolidation of the industry. Market

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[11] See, "Open Skies Agreements" (last updated: 20 January 2017), online: *U.S. Department of States* <https://2009-2017.state.gov/e/eb/tra/ata/index.htm>
[12] Martin Staniland, *A Europe of the Air? The Airline Industry and European Integration* (Lanham: Rowman & Littlefield, 2008) at 133.
[13] "Open Skies Agreement", *supra* note 11.
[14] Rizkia Amelia Sania Putri, *Regional Open Skies Regime in Southeast Asia and its Relevance to Air Transport Deregulation in Indonesia* (LLM Thesis, McGill University Institute of Air and Space Law, 2017) [unpublished] at 1.
[15] Xiaowen Fu, Tae Hoon Oum & Anming Zhang, "Air Transport Liberalization and Its Impacts on Airline Competition and Air Passenger Traffic" (2010) 49, 4 Transport J 24 at 27.
[16] Putri, *supra* note 14 at 1.
[17] Kelvin Balcombe, Iain Fraser, & Liam Harris, "Consumer Willingness to Pay for In-Flight Service and Comfort Levels: A Choice Experiment" (2019) 15:5 Elsevier J Air Transport Management 221 at 221.
[18] Fu, Oum & Zhang, *supra* note 15 at 28.
[19] Hooper, Hutcheson & Nyathi, *supra* note 2 at 397.

consolidation is not an unusual trait of liberalisation,[20] but a higher degree of consolidation can create market monopolies or oligopolies which can result in inefficiencies, drive up airfares and lead to carriers abandoning low-dense routes in pursuit of the lucrative ones. The emergence of oligopolies due to liberalisation can be counterproductive to its aims. In the international aviation market, developing countries fear that liberalisation would favour foreign carriers of the developed countries which would reduce the market share of home carriers. Therefore, developing countries are slow to embrace liberalisation, however, in recent times a new wave of gradual liberalisation is taking place in less developed countries.[21]

Air transport liberalisation, even though has become a common global trait, still lacks a universally accepted definition.[22] It is generally understood as a 'continuum or a political process that leads ultimately to a new paradigm of competitive behaviour where a balance of benefits is replaced by a balance of opportunities.'[23] It usually features the removal of economic regulatory restrictions including free entry and exit of carriers, airfares freely determined by market forces, no restrictions on routes and capacity, removal of government subsidies and privatisation of national carriers.[24] However, most countries decide for themselves how and to what extent liberalisation should be undertaken taking into consideration the peculiar developmental needs of the country. In practice, liberalisation manifests in deregulation and privatisation.[25] In the domestic aviation industry, liberalisation materialises through the removal of regulatory control on the operations of carriers thereby allowing greater private participation.[26] International liberalisation on the other hand depends not just on a State's internal policy to liberalise international air transport, but also on the willingness of the foreign jurisdiction to accept minimal regulatory interference and promote a higher degree of competition.[27]

India, being a developing State, initially opposed the idea of liberalisation both in the domestic and international markets and till the mid-1980s the industry was heavily regulated.[28]

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[20] See Andrew R Goetz & Paul Stephen Dempsey, "Airline Deregulation Ten Years After: Something Foul in the Air" (1989) 54 J Air L & Com 927 at 938.
[21] Hooper, Hutcheson & Nyathi, *supra* note 2 at 396.
[22] Anusha Wickramasinghe, "Liberalization of Air Transport in South Asia - Some Legal and Policy Issue" in David Timothy Duval, eds, *Air Transport in the Asia Pacific* (Burlington, Ashgate Publishing Ltd, 2014) at 236.
[23] Brian F Havel, *Beyond Open Skies: A New Regime for International Aviation* (Austin: Wolters Kluwer Law & Business, 2009) at 584.
[24] Hooper, Hutcheson & Nyathi, *supra* note 2 at 396.
[25] Thomas R Leinbach & Richard Ulack, *Southeast Asia: Diversity and Development* (US: Prentice-Hall Inc, 2000) at 240.
[26] Brian J Graham, *Geography of Air Transport* (Chichester, England; New York: Wiley, 1995) at 52.
[27] OECD, *Deregulation and Airline Competition* (Paris: OECD, 1988) at 78-79.
[28] Baldev Raj Nayar, *The State and International Aviation in India: Performance and Policy on the Eve of Aviation Globalization* (New Delhi: Manohar Publishers & Distributors, 1994) at 2.

Restrictions were placed on foreign and private domestic carriers from operating scheduled services and the national carriers (Air India and Indian Airlines) were granted monopoly.[29] However since the late 1980s, as part of broader economic liberalisation agenda as well as to solve certain issues within the aviation industry like shortage of capacity and poor financial performance of the government carriers, India gradually started opening up the civil aviation sector.[30] Liberalisation first started in the late 1980s in the domestic market with private operators being allowed to commence operations to finally end the monopoly of the government carriers.[31] In the early 2000s, the government took a slew of measures to partially liberalise international air transportation with a few selected countries.[32] Since then to date, India has come a long way gradually liberalising the industry. India emerged as the third-largest domestic aviation market in the world.[33] In a span of two decades, domestic air traffic has grown from 12.8 million in 2001 to more than 144 million in 2019, a growth of more than 1000%. According to the 'Vision 2040 for Civil Aviation Industry in India', the country is on track to become one of the top aviation hubs by 2040 and passenger traffic is expected to grow six-fold to around 1.1 billion.[34]

Several new initiatives, policies and schemes have played important roles in the growth of India's aviation industry.[35] Because of these initiatives, the air transport industry is much more liberal today than it was two decades ago. However, the industry is still not as liberal as the US. In the domestic market, there are restrictions on entry, routes, and capacity[36] while on the other hand, India has restrictive bilateral air service agreements with most countries.[37] While some of these restrictions create a hindrance to the growth of the industry, others are necessary to cater to the peculiar developmental needs of the country. In this context, the study aims to evaluate India's policies on air transport liberalisation, compare the impact of such policies with the US experience, and make policy recommendations to aid in the sustainable growth of the industry in light of the wave of liberalisation.

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[29] *Ibid* at 3.
[30] Paul Hooper, "Liberalization of the Airline Industry in India" (1997) 3:3 Elsevier J Transport Management 115 at 116 [Hooper, "Liberalization in India"].
[31] *Ibid* at 116-17.
[32] Rajesh Singh, "Indian Aviation Policy on Market Access: Is It a Case of Missing the Woods for the Trees?" in Jae Woon Lee, eds, *Aviation Law and Policy in Asia: Smart Regulation in Liberalized Markets* (Leiden: Brill, 2020) 305 at 308-09.
[33] "India Now 3rd Largest Aviation Market in Domestic Air Passenger Traffic: CAPA", *Live Mint* (26 March 2017), online: <https://www.livemint.com/Politics/H9mJDSrD7DZStOeF8BLcaN/India-now-3rd-largest-aviation-market-in-domestic-air-passen.html>
[34] India, Ministry of Civil Aviation & FICCI, *Vision 2040 for the Civil Aviation Industry in India* (Mumbai: 2019) at 3.
[35] *Ibid.*
[36] See chapter 3, para 3.4, *below.*
[37] See India, Ministry of Civil Aviation, *Annual Report 2016-17* (New Delhi: 2017) at para 1.10.

2. Research Question, Objective, and Scope

Despite the rhetoric and general global practices, evidence exists both in favour of and in opposition to the liberalisation of air transportation and while it has documented benefits, if not done properly and at a sound pace can have a detrimental impact on air passengers, air carriers as well as the general economy.[38] It is hypothesised that air transport liberalisation in India can bring immense benefits, but unmindful deregulation can oppose the benefits that it offers. In this context, the research question that is presented is whether the policies adopted by the government of India to liberalise the aviation industry are economically sound and adopted at an appropriate pace to enhance its overall growth and development.

The study examines India's domestic and international aviation policies in the context of global liberalisation. Since India has already shifted from deciding whether to liberalise to deciphering how to liberalise,[39] the paper provides policy recommendations in the aspect of air transport liberalisation in India. The paper compares the journey of liberalisation of the US and India through an analysis of the policies and their effects on the industry. The US, being one of the first countries to embark on the path of liberalisation,[40] offers the opportunity to India to learn from its experience and accordingly adopt policies taking into consideration India's developmental needs. While there are certain factors that set India apart from the US, policymakers in India can draw on the documented experience in the US in shaping India's liberalised aviation market. The paper primarily focuses on the US experience in the initial years succeeding deregulation, which is when the market witnessed the greatest impact of policy changes. Contrary to the US approach, since India adopted a more gradual process of liberalisation,[41] the paper contrasts the impact the Indian air transport industry saw as a result of the policy changes with that of the US and provides policy recommendations inspired by the US experience. The key criteria analysed and evaluated in this paper are the effects of policy changes on the entry and exit of air carriers, the financial performance of the industry, air connectivity including connectivity to remote parts, and airfares. The paper is however limited to an analysis of passenger traffic and does not include other aspects of air transportation like air cargo, airports, etc.

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[38] Goetz & Dempsey, *supra* note 20 at 962.
[39] See chapter 3, *below.*
[40] Paul Hooper, "Airline Competition and Deregulation in Developed and Developing Country Contexts - Australia And India" (1998) 6:2 Elsevier J Transport Geography 105 at 105 [Hooper, "Deregulation: Australia and India"].
[41] See chapter 3, *below.*

3. Thesis Outline and Methodology

The thesis examines India's air transport policies (both domestic and international) and their impacts using a critical and comparative lens. Chapter one of the thesis focuses on the US experience of deregulating both the domestic and international air transport industry along with a discussion on the various economic theories of regulation and deregulation on which air transport deregulation was based. This chapter aims to understand the effects of air transport liberalisation in the US so that lessons could be learnt and applied to the Indian journey of liberalisation. It also provides a general overview of the aviation industry around the world. It maps how the world shifted to a liberalised regime by discussing the freedoms of air[42] and their gradual expansion, the shift to open skies policy, and International Civil Aviation Organization (ICAO) actions toward liberalisation.

Chapter two of the thesis provides a history of the aviation industry in India from the beginning of air transportation till the end of the era of strict regulations. The chapter discusses the motive of the government behind having strict regulations and how it impacted the industry. It includes a discussion on the monopoly granted to government carriers for scheduled operations and their performance therein. A comparison is drawn between the intentions behind the regulations and their impact in India and the US. Thereafter the chapter discusses the factors that motivated the government to liberalise the industry and what differentiates it from the motivating factors behind liberalisation in the US.

Chapter three follows a chronological approach towards tracing the gradual liberalisation in India. The chapter starts by providing an analysis of the regulations in the early days of liberalisation. The second part of the third chapter compares the effects of the policy changes as a result of deregulation in the early years with that of the US. The third part of the chapter focuses on aviation policies in recent times and a critical and comparative analysis with the US experience. This is followed by a discussion on how it impacts competition, passengers, connectivity and performance of the carriers. The ultimate aim of this chapter is to answer, given the current Indian market, whether it would be possible to completely deregulate the domestic aviation industry. The chapter provides policy recommendations in light of the wave of liberalisation to make the market competitive while ensuring its sustainable growth. Special emphasis is put on the US experience discussed in chapter one and what lessons could be learnt to ensure both passengers and carriers do not suffer due to mindless deregulation.

[42] See appendix, *below.*

The last part of the third chapter shifts its focus toward India's international aviation policies. An analysis is conducted on India's bilateral Air Service Agreements (ASA) with other countries to show the gradual progress of Indian aviation policies. While India has open skies/liberal agreements with countries like the US, the United Kingdom (UK), Canada and a few Association of South-East Asian Nations (ASEAN) and other countries, the majority of other ASAs are restrictive in nature.[43] This study emphasizes how open skies ASAs affect the industry *vis-à-vis* regulated ASAs. Moving forward, the thesis critically analyses the National Civil Aviation Policy of 2016 (NCAP), which *inter alia* commits that the government will enter into open skies type ASAs on a reciprocal basis with South Asian Association for Regional Cooperation (SAARC) countries and countries with territory located entirely beyond a 5000 km radius from New Delhi.[44] The analysis focuses on the role that regional open skies ASAs (with the SAARC countries) would play to expedite and move forward the liberalisation process. The chapter also critiques the rationale behind the intention to negotiate open skies with countries beyond the 5000 km mark. The analysis also *inter alia* includes how the open skies policy affects air carriers and passengers, India's anti-trust policies, particularly the Indian Competition Act,[45] and the possibility of entry into global alliances and joint ventures by Indian carriers. Finally, this part ends with the impact of this liberalisation and a critique. Similar to the previous part, this portion of the chapter also compares the effects of US liberalisation to the impact of India's proposed international air transport liberalisation and recommendations therein to avoid the downsides.

The primary methodology of the thesis is a comparative study of the aviation policies of the US with that of India. Detailed analysis is conducted on the various domestic and international policies directly or indirectly affecting aviation alongside studying the impact of those policies on air carriers, passengers, and the general economy of the county. For this purpose, statistical data published on the website of the Directorate General Civil Aviation (DGCA – India) and Department of Transportation (DOT- US) is relied upon along with various literature and government studies on the civil aviation sector in India and US.

[43] *Annual Report 2016-17*, *supra* note 37 at para 1.10.
[44] India, Ministry of Civil Aviation, *National Civil Aviation Policy* (2016) at para 9 [*NCAP*].
[45] *The Competition Act 2002*, Act 12 of 2003 (India) [*Competition Act*].

CHAPTER 1: DEREGULATION: HISTORICAL REVIEW AND CURRENT REGIME IN THE US

This chapter primarily concerns a discussion on regulation and deregulation of the aviation industry in the US. The US took the lead and has shown the world the path of civil aviation liberalisation both domestically and internationally and nations that are still in the process of liberalisation can take lessons from the US experience. The purpose of this chapter is to provide the history of regulations in the US and the transition to a free market. Key takeaways from the US experience would be useful to understand and critically analyse the Indian position. This discussion would serve as a basis for a comparative study of aviation regulations in India.

1. Genesis of Regulations

Prior to the 1920s when civil aviation was becoming a normal mode of travel, the air transport industry was unregulated, but this resulted in market failures and the emergence of destructive competition in the form of monopolies and oligopolies.[46] Around the world, a need was felt to establish comprehensive government regulations. Two theories of regulation emerged: the public interest theory of regulation and the economic theory of regulation.[47] Under the public interest theory, the aviation industry, both international and domestic, as an important mode of public transportation, was considered a 'public utility',[48] and therefore the rationale for regulating the industry in its early years was based on the 'public utility doctrine'. Regulations were justified on the grounds that transportation by air is in the public interest and plays an important role in the socio-cultural and economic development of the nation. The economic theory of regulation, also referred to as the self-interest theory of regulation, was first proposed by George J Stigler and according to this theory, 'a rule, regulation is acquired by the industry and is designed and operated primarily for its benefits'.[49] The theory proposes that 'every industry or occupation that has enough political power to utilise the State will seek to control [new] entry' so that the existing entities in the industry can maximise their own utility.[50] In the domestic aviation market, the existing players stressed on having regulations to ensure new carriers were not allowed to launch services or at least had difficulties entering the market.[51]

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[46] Paul Stephen Dempsey, "Airline Deregulation and Laissez-Faire Mythology: Economic Theory in Turbulence" (1990) 56:2 J Air L & Com 305 at 310-11 [Dempsey, "Laissez-Faire Mythology"].
[47] Dipendra Sinha, *Deregulation and Liberalisation of the Airline Industry: Asia, Europe, North America and Oceania* (Hampshire: Ashgate, 2002) at 81.
[48] George Petsikas, *Airline Deregulation and Competition In The Canadian Air Transport Industry Today, and Prospects for the Future* (LLM Thesis, McGill University Institute of Air and Space Law, 1989) [unpublished] at 41.
[49] George J Stigler, "The Theory of Economic Regulation" (1971) 2:1 The Bell J Economics & Management Science 3 at 3.
[50] *Ibid* at 5.
[51] *Ibid.*

Similarly in the international market, the carriers especially of developing countries sought to protect themselves from foreign competition and therefore stressed on regulating it.

This genesis of regulations based on the 'public utility doctrine' was grounded on three assumptions. *Firstly,* it was assumed that only a regulatory agency could develop a comprehensive aviation route network which would ensure integration of the nation and establish socially desirable aviation services to all parts of the country. It was believed that without a government-backed route plan, airlines would fly only on desirable routes that are profitable and leave out routes with fewer demands.[52] It was in the public interest that the benefits of air travel reach all parts of the country, and everyone could benefit from this modern mode of transportation. *Secondly,* the geographically uniform distribution of aviation routes throughout the country would only be possible if the government incentivised airlines to fly on not-so-profitable routes.[53] This could be either by direct subsidies from the government or through cross-subsidies wherein airlines would be allowed to charge higher fares on popular routes to compensate for the operating losses on other routes.[54] The only way cross-subsidies could be achieved was if the government restricted price competition and allowed airlines to charge desirable fares on high-demand routes. *Thirdly,* since all airlines offer similar services, it is difficult to have product/service differentiation. This would, on one hand, increase duplication of services without, on the other hand, necessarily increasing the demand for those services. It would also prevent the realisation of economies of system integration.[55] Therefore in the interest of protecting the airlines by ensuring optimal utilisation of resources and matching the demand with supply, it would be necessary to strictly regulate the industry. As evident, the rationale for regulations was not just to protect passengers but also the carriers and the economy of the country.

It was for these reasons that the governments deemed it necessary to regulate the industry by granting monopolies to certain carriers.[56] Different modes of granting this monopoly were adopted by different countries. For example, in the US, specific airlines were granted monopoly flying rights on particular routes or in specific regions.[57] In countries like India, the Air

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[52] Elizabeth E Bailey, David R Graham & Daniel P Kaplan, *Deregulating the Airlines: An Economic Analysis* (Washington DC: Civil Aeronautics Board, 1983) at 1-2.
[53] *Ibid* at 2.
[54] Vijayesh D Roy, *The Deregulated Airline Industry: Legal Challenges for the Nineties (*LLM Thesis, University of Georgia School of Law, 199*2)* at 32.
[55] Bailey, Graham & Kaplan, *supra* note 52 at 2.
[56] Hooper, Hutcheson & Nyathi, *supra* note 2 at 1.
[57] *Civil Aeronautics Act,* Pub. L. No. 706, 52 Stat. 977 (1938) (codified as amended at 49 U.S.C. §§ 1301-1552 (1982 & Supp. IV 1986)) (US) [repealed].

Corporations Act of 1953 nationalised the commercial air transport industry and only the government carriers, Air India and Indian Airlines had monopoly rights. By virtue of regulations, high entry barriers were created which severely restricted or prevented the entry of new players into the industry. A corollary to granting monopolies to carriers by means of regulation is rate regulation.[58] Without reasonable checks, it might lead to airlines abusing their monopoly status by exploiting consumers with unreasonably high fares. The government fixed the rates that could be charged taking into account that the airlines recovered their operating costs and earn 'reasonable profits'. Competition among airlines was completely eliminated by the regulatory scheme.

Having discussed the rationale behind regulating the aviation industry, the following sub-sections of the thesis will provide an instance of how this rationale for regulations was legally implemented in the US. A broad overview of the history of aviation regulations in the US will show how law and policy were used as a means to achieve the goal.

2. A Short History of Airline Regulations in the US

The aviation market in the US started in 1914 when the world's first regularly scheduled airline took off from the Municipal Pier in St. Petersburg, Florida.[59] Thereafter regularly scheduled mail services by the US Post Office Department started in 1918.[60] After a few years of an unregulated market, the US government promulgated the Air Mail Act[61] in 1925 and the Air Commerce Act[62] in 1926. The government strived to control the air market with these regulations but stricter economic regulations of commercial air transport were promulgated in the US in 1938 with the passing of the Civil Aeronautics Act 1938.[63] This act was seen as the 'real foundation' of government regulations.[64] The Act established the Civil Aeronautics Authority which later became the Civil Aeronautics Board (CAB) in 1940 was tasked with controlling route entry and exit of airlines, regulating fares, giving subsidies on select routes and limiting competition among airlines by controlling mergers and inter-airline

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[58] J Meyer *et al*, *Airline Deregulation: The Early Experience* (Boston: Auburn House Publishing Co., 1981) at 19.
[59] "The Story of the World's First Airline" online: *IATA* <https://www.iata.org/en/about/history/flying-100-years/firstairline-story/>
[60] Lyndon Baltazar, "Airmail Comes of Age" online (pdf): *FAA* <https://www.faa.gov/about/history/milestones/media/Airmail_Comes_of_Age.pdf>
[61] *Air Mail Act,* Ch. 128, 43 Stat. 805 (1925) (US) [repealed].
[62] *Air Commerce Act*, Ch. 344, 44 Stat. 568 (1926) (US) [repealed].
[63] *Civil Aeronautics Act*, *supra* note 57.
[64] Han Shun Lin, *The Phenomenon of Airline Deregulation: The Influence of Airline Deregulation on the Number of Passengers* (Master Thesis, Urban, Port & Transport Economics, Erasmus University Rotterdam Department of Applied Economics) at 8.

commercial agreements.[65] Regarding entry of carriers, the CAB granted operation certification to carriers[66] and the certificate stipulated the routes the carrier could serve as well as the type of service and number of flights they can offer.[67] Carriers were not free to exit routes without the permission of the CAB.[68] With respect to fares, the CAB instead of directly fixing rates, adopted a rate approval method wherein airlines needed to file their tariffs and the CAB had the power to change the rate either using its own judgement and discretion or on complaints from third parties regarding fares being 'unjust and unreasonable'.[69] Carriers were required to give notice of tariff changes[70] and were not allowed to give any kind of rebate that would result in fares lower than what was filed.[71] CAB was also granted extensive powers to control commercial relationships between airlines as well as between airlines and other public carriers like trucking companies.[72] Control was exercised in the form of granting approvals and any proposal of airline mergers, acquisitions or consolidation needed prior approval of the CAB.[73]

3. Aftermath of Regulations

As a result of these regulations, any scope for competition among airlines was taken away. Carriers had no autonomy in independently deciding their business models. Starting from which routes or city pairs they could serve to what rate could be charged, everything was either decided by the CAB or needed CAB approval. The government board was the decision-maker on all economic aspects of air transportation and carriers simply executed those decisions.

During the coming decades beginning in 1938 when the act was adopted, the domestic aviation industry steadily grew and matured under the regulations. Four classes of commercial air carriers emerged: Trunk carriers, Local service carriers, Interstate carriers and Commuter airlines. There was a consistent pattern of market share among the different classes of carriers with trunk carriers having the highest market share of domestic revenue (87%).[74]

Until the late 1970s, five major airlines (which included United Airlines, American Airlines, Eastern Airlines, TWA and Delta Airlines) that existed prior to the 1938 Act retained market dominance.[75] The major reasons for this dominance were the high entry barriers and the anti-

[65] *Civil Aeronautics Act*, *supra* note 57 at s 201(a) & 401-416.
[66] *Ibid* at s 401(a)-(e).
[67] *Ibid* at s 401(f).
[68] *Ibid* at s 401(k).
[69] *Ibid* at s 403.
[70] *Ibid* at s 403(c).
[71] *Ibid* at s 403(b).
[72] *Ibid* at s 408-413.
[73] *Ibid* at s 408.
[74] Goetz & Dempsey, *supra* note 20 at 934.
[75] *Ibid.*

competitive nature of the regulations. The CAB rejected all seventy-nine applications received between 1950 and 1974 to provide domestic air services.[76] Even though these carriers had a monopoly or oligopoly in certain markets due to their dominance, CAB regulations on 'just and reasonable' fares prevented abuse of this dominance. This era of strict regulations lasted for four decades till 1978.

4. Origin of International Air Transport Regulations

In the 20th century, the aviation industry was one of the most important growing industries and every nation was invested in its development. In the years following World War I, countries were keen on establishing a legal framework to foster its growth and the international community produced the Convention Relating to the Regulation of Ariel Navigation (the Paris Convention)[77] in 1919. According to Article 1 of the convention, every State 'has complete and exclusive sovereignty over the airspace above its territory.' Consequently, flying rights including landing and transit rights of foreign carriers were contingent on the explicit or tacit approval of the concerned States.[78] This ensured that national governments would play a key role in the economic and political development of international aviation.[79]

4.1. The Chicago Conference

The end of World War II demanded a new regulatory regime to deal with the post-war development of international civil aviation. A need was felt for a multilaterally negotiated agreement and in response, the US organised an international conference to bring States together to lay the foundation of the international aviation industry. The conference was attended by fifty-five States which represented most of the aviation powers in the pre-war era.[80] Even though at that time the US had strictly regulated the domestic aviation market, it promoted a free-market philosophy wherein carriers of all countries would have unfettered operating rights in other countries.[81] To achieve this goal, the US proposed multilateral granting of all the five freedoms[82] and insisted that the flight frequency, capacity, airfares and other aspects

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[76] Paul Stephen Dempsey, "The Rise and Fall of the Civil Aeronautics Board: Opening Wide the Floodgates of Entry" (1979) 11:1 Transp LJ 91, 115 [Dempsey, "Rise and Fall of CAB"].
[77] *Convention Relating to the Regulation of Aerial Navigation*, 13 October 1919, 11 LNTS 173. [*Paris Convention*].
[78] Oliver James Lissitzyn*, International Air Transport and National Policy* (AMS Press Inc. 1997) at 365.
[79] Jeswald W. Salacuse, "The Little Prince and the Businessman: Conflicts and Tensions in Public International Air Law" (1980) 45:4 J Air L & Com 807 at 814.
[80] Paul Stephen Dempsey, *Deregulation, Discrimination & Dispute Resolution in International Aviation: Turbulence in the Open Skies* (DCL Thesis, McGill University Institute of Air and Space Law, 1986) [unpublished] at 5 [Dempsey, *Turbulence in Open Skies*].
[81] *Proceedings of the International Civil Aviation Conference: Chicago*, November 1-December 7, 1944 (Washington: U.S. Govt. Printing Off., 1948).
[82] See appendix, *below.*

must be left open to market forces rather than on regulations.[83] The British delegation on the other hand opposed a free-market philosophy and instead proposed an international body which would be responsible for the distribution of international routes, determining capacity, fares, and frequencies. They believed that unfettered competition with foreign airlines, especially the American ones, would be detrimental to their aviation industry and regulation through an international body was necessary to protect the growing industry from direct competition in the international market.[84]

Unfortunately, no consensus could be reached, and nations were not willing to give up their sovereignty to an international body that would formulate and enforce a uniform aviation policy as proposed by the British delegation.[85] Therefore, the formal agreement that was adopted at the conclusion of the conference, the Chicago Convention,[86] did not have any provisions on the economic aspects of civil aviation like route assignment, frequency, capacity, fares etc. Instead, this convention reinstated the Paris Convention principle of complete and exclusive sovereignty over the airspace above a State's territory.

4.2. The Principle of Sovereignty

As discussed earlier, the first article of the Chicago Convention states that 'every State has complete and exclusive sovereignty over the airspace above its territory'.[87] This article simply reiterates and endorses the customary law principle of sovereignty over airspace[88] and Article I of the Paris Convention, 1919. Expanding on the Article 1 principle of sovereignty, Article 6 adds that 'no scheduled international air service may be operated over or into the territory of a contracting State except with the special permission or authorization of that State.'[89]

This, therefore, requires scheduled carriers to get authorisation or permits to fly over or into the concerned States. While the Chicago Convention does not define what constitutes 'permission or authorization', the practice has emerged to gain authorisation through bilateral agreements negotiated between two States. Since the Chicago Convention failed to have provisions on air traffic rights, Article 6, often referred to as the 'Charter of Bilateralism',[90]

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[83] Andreas F Lowenfeld, *Aviation Law: Cases and Materials* (New York: Matthew Bender, 1972) at II-5.
[84] Anthony Sampson, *Empires of the Sky: The Politics, Contests and Cartels of World Airlines* (New York: Random House Inc, 1984) at 67-68.
[85] Dempsey, *Turbulence in Open Skies*, *supra* note 80 at 6.
[86] *Convention on International Civil Aviation,* 7 December 1944, 15 UNTS 295, ICAO Doc 7300/6 (entered into force 4 April 1947) [*Chicago Convention*].
[87] *Ibid* at art 1.
[88] Havel, *supra* note 23 at 99-100.
[89] *Chicago Convention*, *supra* note 86 at art 6.
[90] Yoshinori Ide, *Liberalization of International Air Transport in the Japan-US Market* (LLM Thesis, McGill University, 1998) [unpublished] at 5.

laid down the path for future discussion and negotiations between States to agree on traffic rights.[91]

The consequences of these provisions are strict economic regulations at the hands of each State. States retain exclusive control over the air space above their territory and only State authorities can secure operational and economic regulation of public air service. Carriers do not have access to foreign markets unless it is authorised to fly to that State as per the terms of the bilateral agreement. This is perceived as 'the core value of a new world aviation system: financial stability, operational safety, regularity, and continuity.'[92] Consequently, international air service is seen as a 'concessionary activity' where the grant of market access is not due to the airlines' entrepreneurial initiative but rather on rights approved by the concerned State through bilateral agreements.[93]

It is noteworthy that Article 5 grants some leeway to non-scheduled flights, but no freedom of air travel[94] is granted to scheduled flights. At the Chicago Conference, two other agreements were negotiated – International Air Transport Agreement[95] and International Air Service Transit Agreement (IASTA)[96] – to foster greater freedom for carriers for international air transportation. States negotiated five categories of freedom[97], the first two freedoms are on transit rights of foreign carriers and the remaining three are on traffic rights as they relate to embarking and disembarking passengers, cargo and mail.[98] IASTA grants the transit freedoms and is a successful agreement with most States being signatories.[99] However, the International Air Transport Agreement which granted a multilateral exchange of all five freedoms failed and this made it inevitable for States to negotiate bilateral agreements to exchange these rights.

4.3. Bilateral Air Service Agreements (ASA)

Bilateral ASAs are defined as 'international trade agreements in which governmental authorities of two sovereign States attempt to regulate the performance of air services between their respective territories and beyond.'[100] Traffic rights of foreign carriers are negotiated

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[91] Nicolas Mateesco Matte, *Treatise on Air-Aeronautical Law* (Toronto: Carswell, 1981) at 141.
[92] Havel, *supra* note 23 at 102.
[93] *Ibid* at 103.
[94] See appendix, *below.*
[95] *International Air Transport Agreement*, 07 December 1944, 59 Stat 1701, TIAS No 488, 171 UNTS 387 (not yet in force) [*Air Transport Agreement*].
[96] *International Air Service Transit Agreement*, 07 December 1944, 84 UNTS 389, ICAO Doc 7500 (entered into force on 30 January 1945) [*IASTA*].
[97] See appendix, *below.*
[98] Havel, *supra* note 23 at 105.
[99] *IASTA*, *supra* note 96.
[100] Peter P C Haanappel, "Bilateral Air Transport Agreements: 1913-1980" (1979) 5 Intl Trade LJ 241 at 241.

through these agreements. The first major negotiated ASA post the Chicago Conference was the Bermuda I Agreement between the US and the UK.[101] The following discussion on the provisions of the Bermuda I Agreement demonstrates the extent of regulations that prevailed during that era. Interestingly, the Bermuda I Agreement became a template for ASAs negotiated between States.[102]

4.3.1. The Bermuda I Agreement

This agreement was the first ASA, entered by two leading aviation powers – the UK and the US.[103] It represented a compromise between the US outlook of a liberalised regime and a protectionist approach of the UK[104] and therefore it is often termed a moderate liberal agreement[105]

The Bermuda I featured the freedoms given to carriers to operate international air services between the UK and the US at the capacity and frequency that was deemed justified provided that the other provisions of the convention were complied with. The agreement provided for an *ex post facto capacity determination* wherein decisions regarding flight capacity and frequency were left to be determined by the carriers with *ex post facto* review by the States through consultation.[106] However, while determining this capacity, carriers had to give 'fair and equal' opportunity to the carriers of the other State and the capacity offered should correlate to the traffic requirements between the countries.[107] This implied that if the carrier of one State was earning revenue higher than the carrier of the other State by offering higher capacity, then that carrier had to reduce its capacity to give fair and equal opportunity to the carrier of the other State. Evidently, the purpose of the agreement was not to foster competition among airlines but to benefit consumers. Furthermore, Article 6 stressed on the fact that capacity should be determined on the basis of traffic demand between the two countries only and therefore it restricted fifth freedom.[108] Under Article 2, the designation of the carrier was a precondition for the exercise of traffic rights, but the agreement allowed multiple designations. These provisions on capacity determination with *ex post facto* review and multiple designations were

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[101] *Air Service Agreement between the United Kingdom and the United States*, 11 February 1946, 3 U.N.T.S. 253, 60 Stat. 1499, T.I.A.S. No. 1507 [*Bermuda I*].
[102] Matte, *supra* note 91 at 522.
[103] Paul Stephen Dempsey, *Law and Foreign Policy in International Aviation* (New York: Transnational Publishers, Inc., 1987) at 57 [Dempsey, *Law and Foreign Policy in Aviation*].
[104] Barry R. Diamond, "The Bermuda Agreement Revisited: A Look at the Past, Present and Future of Bilateral Air Transport Agreements" (1975) 41 J Air L & Com 419 at 420.
[105] Havel, *supra* note 23 at 111.
[106] *Bermuda I*, *supra* note 101 at para 6 read with appendix I art 6.
[107] *Ibid* at para 4 & 6.
[108] See appendix, *below.*

seen as moderately liberal approaches to bilateralism. But the provisions on pricing were the least liberal. Though carriers could negotiate and agree on fares on routes through the International Air Transport Association (IATA) conference, any modification of fares required approval from the aeronautical authorities of both States[109] – a double approval method.

4.3.2. Bermuda II Agreement [110]

As mentioned earlier, Bermuda I became the prototype for worldwide ASAs. But many nations wanted a more restrictive regime compared to Bermuda I to protect their underdeveloped aviation industry. These States insisted on equal sharing of traffic rights[111] and the moderately liberal provision on capacity in Bermuda I got replaced by 'predetermination of capacity'.[112] Following this, the liberalism between the US and the UK also took a step backwards. UK decided to invoke the termination clause in Article 13 which provided for the termination of the agreement one year after receipt of the notice of termination by the other contracting party. The decision of the UK came as a result of the 'US refusal to maintain previously-agreed capacity control.'[113]

The Bermuda I system of *ex post facto* review of capacity determination was replaced with restrictions that were negotiated and codified in the treaty itself.[114] While the Bermuda II Agreement kept the restrictive provisions on fares (double approval with veto powers by either government), capacity on routes was capped and regulated. Annex I of the agreement divided routes into two categories - UK onwards traffic to the US and US onwards traffic to the UK. The Annex prescribed a combination of points on the Atlantic, Pacific, Caribbean and around the world within each category that could be served. Moreover, Article 11 of the Bermuda II agreement literally interpreted the fair and equal principle of Bermuda I and provided that when a carrier of one State offers new services on a route that is already served by the designated carrier of another State, the incumbent carrier must 'refrain from increasing the frequency of their services to the extent and for the time necessary to ensure that the airline inaugurating service may fairly exercise its rights.'[115] This type of provision is called the 50/50 capacity rule where capacity is equally shared between the carriers of the two States. This capacity restriction

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[109] *Bermuda I*, *supra* note 101 at annex II.
[110] *Agreement on Air Transport Services*, United States-United Kingdom, 17 March 1978, TIAS No 8964 [*Bermuda II*].
[111] Bin Cheng, *The law of International Air Transport* (New York: Oceana Publications, 1962) at 241.
[112] Peter P C Haanappel, *Pricing and Capacity Determination in International Air Transport: A Legal Analysis* (Boston: Kluwer Law and Taxation Publishers, 1984) at 35.
[113] Havel, *supra* note 23 at 116.
[114] *Ibid* at 116.
[115] John W Snow, "Aviation Regulation: A Time for Change" (1975) 41:4 J Air L & Com 637 at 641.

coupled with predetermined routes virtually eliminated any form of competition between foreign carriers and in the words of US Senate Commerce Committee Chairman Howard Cannon 'the greatest step backwards in forty years of attempting to bring market-oriented competition to international aviation.'[116]

5. Critique of Regulations

As seen the US domestic market and the international air service market were strictly regulated in terms of fares, routes, and price competition till at least the late 1970s. These regulations affected the airline industry and the industry utilised more resources to produce the desired services as a result of price being set by the regulators instead of by competition among carriers.[117] In the US domestic market as well as in the international market during the era of the Bermuda I Agreement, airlines had a limited scope of competition through flight schedules instead of price competition. Airlines, particularly in the domestic market, ended up offering more services and this overcapacity led to over-scheduling and the airline load factor being depressed.[118] The consequence of this was either higher fares or losses for the airline. Higher fares often result in a lower break-even load factor[119] and this could result in industry losses.

Since airlines could not indulge in price competition, there emerged non-price competition like quality and quantity of services. It was found that airlines were competing 'for their patronage through elaborate cuisine, free drinks, attractive stewardesses, multi-coloured planes, piano bars, and of course, schedule frequency.'[120] As a result of this non-price competition, airlines incurred higher costs which were eventually passed down to consumers. A passenger was forced to buy not only his/her seat but also the associated services which he/she might not purchase if given the choice of a cheaper option without the services. This is not to say that no passenger would prefer these services at the extra cost. But because of over-scheduling and extra services, many passengers were robbed of the opportunity to choose a less costly flight with fewer amenities, a possibly less conveniently scheduled flight or a more passenger-filled flight.[121] These extra services came at a cost which could otherwise have been saved and passengers could have benefitted from the option of lower fares if the airlines were competing

[116] Paul Stephen Dempsey, "Turbulence in the "Open Skies" The Deregulation of International Air Transport" (1987) 15:2 Transp LJ 305 at 332 [Dempsey, "Deregulation of International Air Transport"].
[117] Snow, *supra* note 115 at 641.
[118] *Ibid* at 641.
[119] George W Douglas & James Clifford Miller, *Economic Regulation of Domestic Air Transport: Theory and Policy* (Washington D.C.: Brookings Institution, 1974) at 40.
[120] Snow, *supra* note 115 at 642.
[121] William A Jordan, *Airline Regulation in America: Effects and Imperfections* (Westport Connecticut: Greenwood Press, 1970) at 200.

on fares. Furthermore, limited/restricted entry on routes also resulted in monopolies/oligopolies and fewer options for the passengers. Moreover, regulations also caused the industry to operate inefficiently. In the domestic industry, closed-door restrictions,[122] mandatory stop requirements[123] and long-haul restrictions,[124] and in the international markets restrictions on fifth freedom[125] and restriction on points in the foreign State that could be served were some of the regulations that impeded an airline's capacity to design its services as per market demand thereby providing limited options to passengers. Because of these restrictions, the entrepreneurial endeavour of airlines was diminished as they could not offer the desired services to attract customers, rather their services were aimed at satisfying the regulatory requirements.

In essence, restrictions on pricing and entry resulted in inadequate options and higher airfares for customers, insufficient price competition, higher operating costs, and lower profits for the industry.[126]

6. Domestic Deregulation in the US

Given the criticism of regulations, doubts were expressed, and winds of deregulation started to howl in the academic circle which ultimately influenced policymakers to take affirmative actions to deregulate the industry.

6.1. Advocacy for and Theories of Deregulation

As early as 1951, Lucile Keyes identified CAB regulations as inefficient and asserted that government control of the aviation industry was not required.[127] However, her findings received criticism for being inadequate as an empirical matter.[128] Then in 1962, Richard Caves using empirical evidence suggested that competition among airlines would give passengers rational route choices.[129] Drastic advocacy for deregulation was put forth by Michael Levine in 1965. He studied the performance of regulated interstate carriers in the US and largely

[122] 'Closed door restrictions…prevent carriers from providing service for local passengers.' Snow, *supra* note 115 at 643.
[123] 'Mandatory stop requirement…prevents the carrier from providing direct non-stop air service between two points.' *Ibid* at 643.
[124] 'Long-haul restriction…requires carriers to fly beyond their logical terminus.' *Ibid* at 643.
[125] See appendix, *below.*
[126] Dempsey, *Law and Foreign Policy in Aviation, supra* note 103 at 24.
[127] Lucile Sheppard Keyes, *Federal Control of Entry into Air Transportation* (Cambridge: Harvard University Press, 1951).
[128] Sam Peltzman, Michael E Levine & Roger G Noll, "The Economic Theory of Regulation after a Decade of Deregulation." (1989) *Brookings Papers on Economic Activity: Microeconomics* at 47.
[129] Richard E Caves, *Air Transport and Its Regulators Study* (Cambridge: Harvard University Press, 1962).

unregulated intra-state carriers in California to point out the difference in performance.[130] Levine's findings were affirmed and strengthened by a 1970 study by William Jordan.[131]

Thereafter, renowned economists like George Douglas and James Miller used economic models of airline competition to demonstrate that the industry is naturally competitive and recommended against regulations.[132] Support for deregulation was strengthened when George Edas demonstrated the redundancy of CAB regulations. In his study, he explained that despite CAB regulations and subsidies, major carriers had abandoned smaller communities and that they were mostly served by unregulated commuter carriers with no rate or route regulations.[133] As advocacy for deregulation gained pace, economists justified the need for deregulation based on the contestability theory.

6.2. The Theory of Contestable Markets

The 'theory of contestable markets' on which aviation deregulation was based states that the performance of the market does not depend on the number of players in the market if entry and exit to the market are costless and there is full access to technology.[134] The primary elements of this theory are costless entry and exit, price sustainability, no significant economies of scale and equal access to technologies.[135] In the aviation industry, the theory implies if the entry and exit of carriers are costless, the possibility of entry of a new player would regulate the incumbent players in terms of routes and price. Therefore, even if the aviation market is not characterised by multiple competitors, fear of entry of a competitor would make the market competitive and discipline the industry. Writings of three scholars on contestability theory are of particular interest as they provided the justification for deregulation of the airline industry in the US and were responsible for its implementation as well. Alfred Kahn - the father of US deregulation - explained that the aviation market is monopolistic/oligopolistic in nature as it can support only a few carriers on a given route at a given time, but the market could still be conducive to competition if the potential entry of new players is eased by removing regulations. The constant threat of entry of a new player prevents monopolistic exploitations.[136] Therefore,

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[130] Michael E Levine, "Is Regulation Necessary? California Air Transportation and National Regulatory Policy" (1965) 74:8 Yale LJ 1416.
[131] Jordan, *supra* note 121.
[132] Douglas & Miller, *supra* note 119.
[133] George C Eads, "Competition in the Domestic Trunk Airline Industry: Too much or Too Little" in Phillips Almarin, ed, *Promoting Competition in Regulated Markets* (Washington D.C.: Brookings Institution, 1975).
[134] Levine, *supra* note 130 at 404-05.
[135] Paul Stephen Dempsey & Laurence E Gesell, *Airline Management Strategies for the 21st Century,* 2nd ed (Arizona: Coast Aire Publications. 2006) at 90 [Dempsey & Gesell, *Airline Management*].
[136] Alfred Kahn, "Talk to the New York Society of Security Analysts" (New York City: February 2, 1978).

the contestability theory does not require firms to actually compete against each other to produce efficient competition. Prof Paul Dempsey explained that since entry would be costless, if airlines behaved in an anti-competitive way, they 'would be faced with new competitors attracted like sharks to the smell of blood.'[137] In other words, Elizabeth Bailey, *et al,* described that:[138]

> Actual competition in the market along with potential competition for the market would be effective in guaranteeing that supernormal profit would not be achieved. Thus, even in markets with substantial natural monopoly characteristics, the framers of deregulatory policy felt that carriers would not be able to set fares substantially above costs without inviting entry.

With this optimism for deregulation and given the critique of regulations, in 1978, the Airline Deregulation Act[139] was passed in the US to amend the Federal Aviation Act (FAA) of 1958.

6.3. The Deregulation Act of 1978

The overarching theme of the 1978 Deregulation Act, which deals with domestic deregulation, is competition. The objective of the act, which is laid down in Section 3 provided, *inter alia,* for:[140]

- High priority in safety.
- Equitable working conditions and fair wages.
- Maximum emphasis on competition to provide domestic air service and earn profits.
- Entry of new carriers and expansion of service by incumbent carriers.
- Abstention of unfair, deceptive, predatory, or anticompetitive practices and prevention of industry concentration, excessive domination and monopoly.
- Ensure scheduled air service to small communities with federal support if necessary.

The purpose of the act was to ensure a swift transition from regulation to deregulation through the gradual elimination of government restrictions over routes, entries, exits and fares between 1978 to 1982 and finally dissolving the CAB in 1985.[141] Title XVI of the act contained the 'Sunset Provisions' which provided for various regulatory provisions to be sunset between

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[137] Dempsey & Gesell, *Airline Management*, *supra* note 135 at 90.
[138] Elizabeth Bailey, David Graham & Daniel Kaplan, *Deregulating the Airlines* (Cambridge: MIT Press, 1985) at 153.
[139] *ADA, supra* note 7.
[140] *Ibid,* s 3 (codified as 49 U.S.C. §1302 (a), recodified as 49 U.S.C § 40101).
[141] *Ibid,* s 40 (codified as 49 U.S.C.§ 1551) [ceased to be in effect].

December 1981 and January 1985.[142] Technically, this was accomplished by declaring certain portions of the amended FAA to 'cease to be in effect' as of the sunset date.[143] The Civil Aeronautics Board Sunset Act of 1984 amended the Federal Aviation Act of 1958 to terminate certain functions of the CAB and transfer others to the Department of Transportation (DOT).[144]

6.3.1. Route Deregulation

With the new act, entry of carriers on new routes was significantly liberalised and the burden of the applicant to prove that the proposed air transportation was 'consistent' with public convenience and necessity was replaced by the 'fit, willing and able' test.[145] Accordingly, CAB certification for new route entry was granted after a public hearing if the applicant could prove that it was 'fit, willing, and able to perform such transportation properly and to conform to the provisions of this Act and the rules, regulations, and requirements of the Board hereunder.'[146] Route access was therefore open to any carrier that could satisfy the fitness test.

Apart from diluting CAB's traditional gatekeeper role in route admission, the act carved out certain categories of dormant/unused routes that were eligible for a lesser degree of administrative intervention by the CAB. Unused authority allowed the CAB to award certain underutilised routes to new entrants and the CAB was required to grant the applications expeditiously within fifteen days.[147]

CAB continued administering these route regulations until its sunset on 31 December 1981.[148] The act was silent on how the fitness test would be discharged after the demise of the CAB. This omission was corrected with a decision by the government that the fitness test should continue as it does not create a substantial barrier to entry and henceforth be within the domain of the DOT.[149] The law as it stands today is that carriers are free to enter and exit markets at their discretion subject only to the requirement of proving fitness to the satisfaction of the Secretary of Transportation, DOT.[150] Even exiting requirements were eased, and carriers had

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[142] *Ibid,* s 40.
[143] Havel, *supra* note 23 at 257.
[144] *Civil Aeronautics Board Sunset Act*, Pub. L. 98-443; 98 Stat. 1703 (1984) (US) [*Sunset Act*].
[145] *ADA*, *supra* note 7, s 14 (codified as 49 U.S.C. § 1371(d), recodified as 49 U.S.C. § 41102(b)).
[146] *Ibid.*
[147] *Ibid,* s 10 (codified as 49 U.S.C. § 1371(d)(5)) [ceased to be in effect].
[148] *Ibid,* s 40 (codified as 49 U.S.C.§ 1551(a)) [ceased to be in effect].
[149] Havel, *supra* note 23 at 258.
[150] 49 U.S.C. § 41102(b).

to provide a notice period of only ninety days[151] and as of 31st December 1981, there is no notice requirement for non-essential services.[152]

6.3.2. Airfare Deregulation

Fares were also deregulated and till 1983 carriers could alter fares within a certain range by giving a notice period of thirty days.[153] The CAB no longer has the authority to find whether a fare is unjust or unreasonable for being too high or low.[154] Carriers could price freely without regulatory interference provided that they complied with the statutory price ranges. The deregulation act established a Standard Industry Fare Level (SIFL)[155] and carriers were free to increase fares up to 5% of the SIFL and decrease fares up to 50% of the SIFL.[156] The CAB retained the power to suspend fares above or below the SIFL on the grounds of being unduly preferential, unduly prejudicial, unjustly discriminatory or predatory.[157] The SIFL was updated semi-annually taking into consideration changes in operating cost per available seat mile.[158]

The act's sunset provisions called for the termination of CAB's fare regulatory authority by 01 January 1983 and all regulations on airfares ceased to be in effect.[159]

6.3.3. Antitrust Deregulation

Anti-trust provisions too were deregulated with the Airline Deregulation Act. Till the demise of the CAB, the board was granted broader powers to exempt the application of general antitrust laws to the airline industry if the board was of the opinion that the exemption was required in public interest.[160] The CAB was required to ensure that the exemption would not 'result in a monopoly or would be in furtherance of any combination or conspiracy to monopolise or to attempt to monopolise the business of air transportation in any region' and that the proposed transaction would not lessen competition unless the anticompetitive effect of the proposed transaction outweighed public interest of meeting significant transportation conveniences.[161]

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[151] *ADA*, *supra* note 7, s 19 (codified as 49 U.S.C. § 1371 (j)) [ceased to be in effect].
[152] *Ibid,* s 40 (codified as 49 U.S.C. § 1551 (a)) [ceased to be in effect].
[153] *Ibid,* s 22 (codified as 49 U.S.C. § 1373 (c)) [ceased to be in effect].
[154] *Ibid,* s 37 (codified as 49 U.S.C. § 1482 (d) (4)) [ceased to be in effect].
[155] The CAB established a Standard Industry Fare Level (SIFL), based upon fares in effect on July 1, 1979. The CAB periodically updated the SIFL by the percentage change in airline operating cost per available seat-mile. The SIFL was the standard against which a statutory zone of reasonableness is measured; "Standard Industry Fare Level" (last updated 25 February 2021), online: *U.S. Department of Transportation* <https://www.transportation.gov/office-policy/aviation-policy/standard-industry-fare-level>
[156] *ADA, supra* note 7, s 37 (codified as 49 U.S.C. § 1482 (d)(4)) [ceased to be in effect].
[157] *Ibid*.
[158] *Ibid,* s 37 (codified as 49 U.S.C. § 1482 (d)(6)) [ceased to be in effect].
[159] *Ibid,* s 40 (codified as 49 U.S.C. § 1551 (a)(2)) [ceased to be in effect].
[160] *Ibid,* s 30 (codified as 49 U.S.C. § 1378, 1379, 1382) [ceased to be in effect].
[161] *Ibid,* s 26 (codified as 49 U.S.C. § 1378) [ceased to be in effect].

Therefore while a clearly monopolistic merger could not be saved, the new public interest exemption allowed the board to approve transactions that would otherwise be restricted by the anti-trust laws (The Clayton Act).[162]

Upon CAB's demise, the power to monitor anti-competitive practices and grant immunities was transferred to the DOT in January 1985.[163] However, in 1989, DOT's anti-trust authority came to an end[164] and thereafter the power was given to the Department of Justice (DOJ) in the hope of greater enforcement of anti-trust regulations amidst rising criticism of the DOT rubberstamping merger applications without reviewing on merits.[165] With this, any proposed airline mergers and agreements are now subject to general antitrust laws enforced by the DOJ instead of the anti-trust provisions of the Airline Deregulation Act.[166] At the same time, the DOT, however, retains the authority to halt 'unfair or deceptive practice[s] or unfair method[s] of competition in air transportation…'[167] Therefore, both DOJ and DOT are currently responsible for overseeing anti-competitive practices in the airline industry, though the extent of oversight differs in scope.

6.3.4. Essential Air Service (EAS) Program

Lastly, recognising that deregulation might affect services to remote regions, the act provided for Essential Air Service Program to small communities.[168] It provided for a ten-year programme of federal subsidies and compensation to be paid to carriers to continue providing essential air services to eligible points (remote areas) as determined by the board.[169] Noteworthily, this provision was based on the principle of rewarding carriers rather than mandating them to fly to small communities and carriers were free to exit the route after giving due notice. Although the programme was supposed to be ceased after ten years, it was placed under the DOT on 01 January 1985.[170] It was renewed for an additional ten years in 1988[171] and thereafter renewed indefinitely through the elimination of the sunset provision in 1998.[172]

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[162] Havel, *supra* note 23 at 260-61.
[163] *Sunset Act*, *supra* note 144 at s 3(a).
[164] *Ibid.*
[165] Paul Stephen Dempsey, "Regulatory Schizophrenia: Mergers, Alliances, Metal-Neutral Joint Ventures and the Emergence of a Global Aviation Cartel" (2018) 83 J Air L & Com 3 at 20.
[166] Lucile Sheppard Keyes, "The Regulation of Airline Mergers by the Department of Transportation" (1988) 53 J Air L & Com 737 at 740.
[167] 49 U.S.C § 41712.
[168] *ADA, supra* note 7, s 33 (codified as 49 U.S.C. § 1389, recodified as 49 U.S.C. § 41731-41742).
[169] *Ibid.*
[170] *Ibid* at s 40 (codified as 49 U.S.C. § 1551 (B)(1)(A)) [ceased to be in effect].
[171] Havel, *supra* note 23 at 264.
[172] 49 U.S.C. § 41742.

6.4. The US Experience - Effects of Domestic Deregulation

After the adoption of the Deregulation Act, the domestic industry witnessed tremendous changes in various aspects. Since 1978 till recent times the US airline industry has experienced several phases of expansion and retrenchment which have affected the market structure, profitability, services, and airfares. This section provides an overview of the US domestic deregulation experience.

6.4.1. Entry of Carriers and Industry Concentration

In the first phases, immediately after deregulation, between 1978 and 1983, the US industry saw a drastic increase in the number of new carriers.[173] The ten trunk carriers[174] that existed prior to deregulation witnessed a decline in market share from 87% to 75% by 1983 along with losses in revenue during the early years.[175] This change in the market pattern was due to the stiff competition that trunk carriers faced not only from the new entrants[176] but also from the former intra-state[177] and local service carriers[178] which expanded their services on the trunk routes and consequently experienced a growing market in the initial years of deregulation.[179] They expanded their route systems as well. The trunk carriers were not as flexible to adapt to the new environment as the new entrants and other carriers.[180]

However, after the initial increase in new carriers and new services by old carriers, the US market saw a dramatic shift in the second phase between 1983 and 1993. The number of carriers offering services started reducing as the industry experienced unprecedented and unlimited mergers and bankruptcies.[181] By 1988, there were fifty-one airline mergers and acquisitions.[182] In the latter half of the second phase, the former trunk carriers were able to strike back, and they grew through mergers and acquisitions leading to increased concentration and market share. After the demise of some carriers like Braniff, Eastern Airlines, and Pan Am, and the absorption of Western Airlines into Delta Airlines, major airlines like American, Continental,

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[173] Goetz & Dempsey, *supra* note 20 at 936.
[174] American, Braniff, Continental, Delta, Eastern, Northwest, Pan Am, TWA, United, and Western.
[175] Andrew R Goetz & Timothy M Vowles, "The Good, The Bad and The Ugly: 30 Years of US Airline Deregulation" (2009) 17 Elsevier J Transport Geography 251 at 253-54.
[176] These included America West, Jet America, Midway, Midwest Express, Muse, New York Air, and PEOPLExpress.
[177] These included Air California, Air Florida, Pacific Southwest, and Southwest.
[178] These included Frontier, Ozark, Piedmont, Republic, US Air.
[179] Goetz & Dempsey, *supra* note 20 at 937.
[180] *Ibid* at 937.
[181] *Ibid* at 938.
[182] Dempsey, "Laissez-Faire Mythology", *supra* note 46 at 325.

Delta, Northwest, United, and US Airways became the dominant players through acquisitions and alliances with regional and commuter airlines.[183]

This re-established the oligopolistic nature of the industry and resulted in the consolidation which created 'a small class of megacarriers that…[controlled] an even larger share of the airline market than they did prior to deregulation.'[184] By the end of the 1980s and the beginning of the 1990s, the domestic traffic share of the six largest airlines had increased to 79% and the top five carriers accounted for 72% of revenue passenger miles.[185] This market consolidation and oligopoly was blamed on the DOT for approving every merger that was submitted to it. Kahn characterised this as an 'uncomfortably tight oligopoly'[186] and claimed 'it is absurd to blame deregulation for this abysmal dereliction' of the DOT to permit every merger and acquisition.[187] However, Prof. Dempsey explained that it was wrong to attribute the problem of mergers to DOT as free entry and exit are simply characteristics of an unregulated market.[188] It must be noted that even though such oligopoly existed during regulations, the problem of oligopoly in an unregulated market is that there are no restrictions on fares and carriers are free to exploit which was earlier restricted by price regulations.

The second phase of a highly concentrated oligopolistic market ended in 1993 and the third phase between 1993 and 1996 started with another wave of expansion featuring new entrants like Frontier, JetBlue, Kiwi, Midway, Reno, Spirit, ValuJet/AirTran, Vanguard, and Western Pacific.[189] Nearly all the new carriers focused on a low-fare business model.[190] These new carriers with their new business model along with the other carriers that entered earlier but did not merge with the trunk carriers expanded their market and the share of the former trunk carriers or majors declined again.

The fourth phase between 2000 and 2009 featured a difficult period for the US airline industry. Several incidents like the catastrophic terrorist attack on 11 September 2001 followed by an unprecedented four-day shutdown of the airline system, a prolonged period of low demand due to economic recession (2007-08), heightened security restrictions, the SARS outbreak,

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[183] Goetz & Vowles, *supra* note 175 at 254.
[184] Goetz & Dempsey, *supra* note 20 at 937.
[185] Paul Stephen Dempsey, "Antitrust Law and Policy in Transportation: Monopoly is the Name of the Game" (1987) 21:3 Ga L Rev 505 at 543.
[186] Alfred Kahn, "Despite Waves of Airline Mergers, Deregulation Has Not Been a Failure" *Denver Post* (31 August 1986) at 3G.
[187] Alfred E Kahn, "Airline Deregulation -A Mixed Bag, But a Clear Success Nevertheless" (1988) 16 Transp LJ 229 at 234.
[188] Goetz & Dempsey, *supra* note 20 at 940.
[189] Goetz & Vowles, *supra* note 175 at 254.
[190] Robert Peterson, "Impact of Airline Deregulation" (2018) 315 TR News: 40 Years of Transportation Deregulation: Airlines, Railroads, Trucking, Intercity Buses 10 at 13.

concerns over the invasions of Afghanistan and Iraq, and rising fuel costs caused a storm within the industry. Even before the 2007-09 recession could hit, the industry lost nearly USD 35 billion between 2001 and 2005.[191] The major carriers which were already going through a decline in market share were badly affected. Carriers like Northwest, United Airlines, Delta Airlines and US Airways filed for bankruptcy by 2002. In the same period, TWA was acquired by American Airlines, and US Airways merged with America West.[192] In contrast, LCCs like Southwest and JetBlue were not as badly affected as the major carriers and in fact, remained.[193]

In the current phase (2009 to date), following the 2007-09 recession, the US airline industry underwent a considerable restructuring that resulted in an unprecedented period of capacity shortage.[194] The industry by the end of 2010 had already morphed into an oligopoly.[195] Forty years since deregulation, the US industry has eighteen major carriers and another forty-five scheduled carriers,[196] but the industry is concentrated in the hands of a few – American Airlines, Delta Airlines, United Airlines and Southwest Airlines which account for nearly 65% of all air travellers in the country.[197] Even in recent years, the industry experienced a few bankruptcies of smaller airlines,[198] but it is unlikely that the market would consolidate further due to its oligopolistic nature with market dominance by a few carriers.

6.4.2. Financial Performance

The numerous bankruptcies and market failures even after thirty years of deregulation portray a partial image of the poor financial performance of the industry. However, a look at the profitability of US carriers reveals a complete picture – that the ugliest aspect of US deregulation has been the financial performance of the industry.

While there had been some highly profitable periods, such as 1995–2000, there had been some astonishingly unprofitable periods, such as 1990–1994 and especially 2001–2005. Chart 1.1 reveals a cynical pattern of the US carriers' financial performance. Every period of profitability

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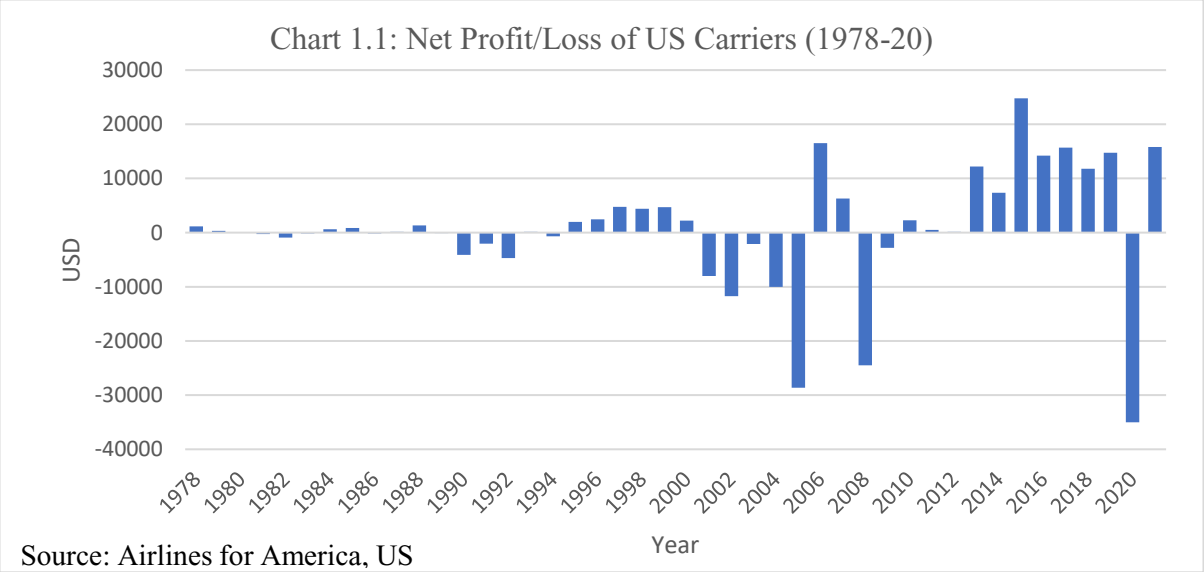
[191] Goetz & Vowles, *supra* note 175 at 254.
[192] *Ibid.*
[193] *Ibid.*
[194] US, Federal Aviation Administration, *FAA Aerospace Forecast: Fiscal Years 2019-2039* (Washington D.C., 2019) at 11.
[195] *Ibid.*
[196] Luke Bodell, "How Many Scheduled Airlines Does the United States Have" (06 January 2022), online: *Simple Flying* <https://simpleflying.com/united-states-scheduled-airlines/>
[197] David Byers, "Airline Deregulation at 40: Airport Perspective" (2018) 315 TR News: 40 Years of Transportation Deregulation: Airlines, Railroads, Trucking, Intercity Buses 20 at 21.
[198] "U.S. Airline Bankruptcies" (24 August 2022), online: *Airlines for America* <https://www.airlines.org/dataset/u-s-bankruptcies-and-services-cessations/>

was followed by a period of loss and what was more troubling was that the amplitudes of the cycle and the degree of losses keep getting larger than the previous degree of gains.

This cycle of profit and loss along with bankruptcies continued for thirty years after deregulation until the current phase post-2009 when the industry became consistently profitable. The trend of profitability continued till the end of 2019 when carriers again reported losses due to the Covid-19 pandemic.



Source: Airlines for America, US

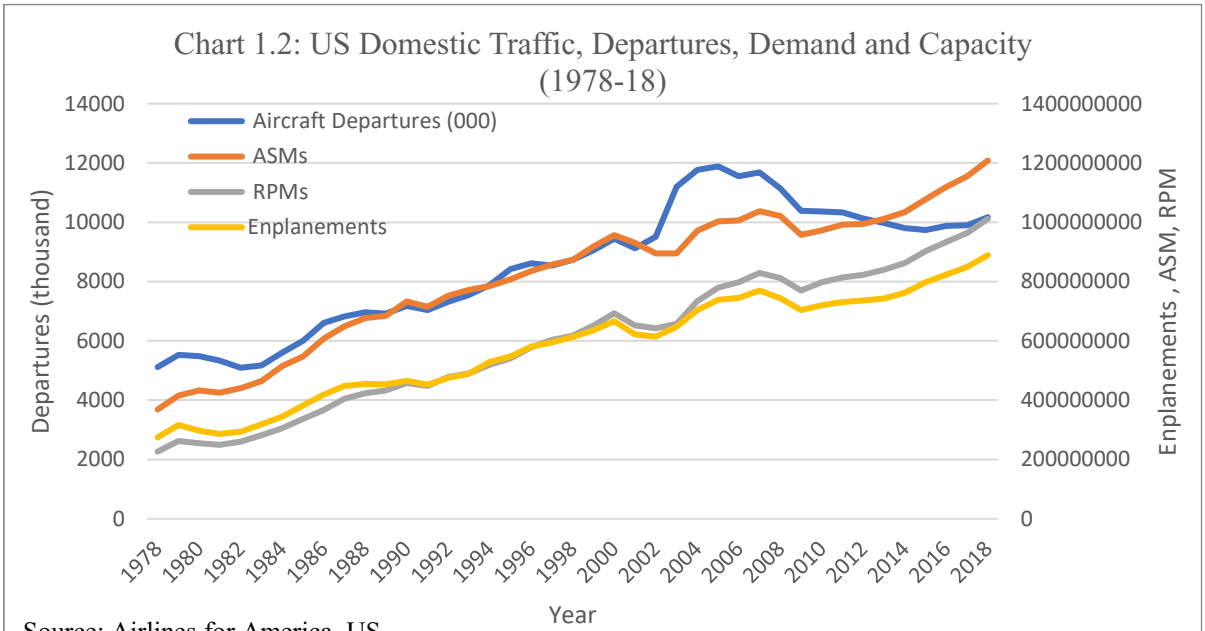
6.4.3. Connectivity and Services to Small Communities

Notwithstanding the oligopolistic nature of the industry, deregulation paved the path for the entry of new carriers and the incumbents to expand their services and routes while implementing innovative business strategies. These changes benefitted a vast majority of customers through not all to the same degree.[199]

Prior to deregulation, routes were awarded to carriers and the CAB usually followed a practice of giving a mix of high and low-density routes to allow for cross-subsidisation for revenue lost on non-popular routes.[200] Without the CAB, carriers are now free to choose their domestic routes and airlines have adopted a 'hub and spoke' approach to be able to serve more city pairs. This hub and spoke approach indeed causes a multiplier effect on the number of origins and destinations that can be served.[201] It gives greater choice and variety of connections[202] and leads to an increased number of services not only to cities serving as hubs but also to large and

[199] Goetz & Vowles, *supra* note 175 at 254.
[200] Dempsey, "Rise and Fall of CAB", *supra* note 76 at 112-13.
[201] Goetz & Dempsey, *supra* note 20 at 944.
[202] Melvin A Brenner, James O Leet & Elihu Schott, *Airline Deregulation* (Westport: ENO Foundation for Transportation Inc., 1985) at 37.

medium-sized cities (spokes). This has caused an increase in weekly departures and seats.[203] The average number of carriers on a given route is also higher than it was during regulations. Routes with higher traffic density also experience better service quality.[204] In a span of forty years since deregulation the number of departures, the number of passengers as well as demand (measured in Revenue Passengers Kilometre (RPK)) and capacity (measured in Available Seat Kilometre (ASK)) has substantially increased. While it can be argued that these numbers would have increased even without deregulation, they most likely would not have been this high.[205]



Source: Airlines for America, US

The increased quality and number of services to large and medium cities post-deregulation led to route rationalisation and smaller communities became the victims of deregulation. Small communities are typically served by regional carriers who usually have a code-share agreement with major carriers. Under these agreements, regional airlines operate on behalf of the major carriers who market and ticket these flights. The regional carriers bring the passengers from small communities to the hub of the major carriers from where they are transported onwards.[206] These services are subsidised by the EAS program. Despite the subsidies and regional carriers with appropriate resources like smaller aircraft flying on regional routes, empirical evidence shows that indeed small communities are negatively impacted.

[203] Goetz & Dempsey, *supra* note 20 at 945.
[204] Brenner, Leet & Schott, *supra* note 202 at 37.
[205] Goetz & Vowles, *supra* note 175 at 254.
[206] Silke Januszewski Forbes & Mara Lederman, "The Role of Regional Airlines in the US Airline Industry" in Darin Lee, eds, *Advances In Airline Economics: The Economics of Airline Institutions, Operations and Marketing* (Amsterdam: Elsevier, 2007) 193 at 193-95.

In the initial year, the number of non-hub departures declined from 23% of all departures in 1978 to only 16% in 1987.[207] There was a decline in seat capacity as well which indicate a shift from jet aircraft to small turboprop aircraft thereby deteriorating the quality of services.[208] Many such communities had also undergone severe service curtailment and even complete withdrawal. Since deregulation, about one hundred and forty small towns have lost all air services.[209] Prof Dempsey notes that:[210]

> [o]ut of the 515 nonhub communities receiving air service in 1978, 313 (60.8%) had declines in flight frequencies by 1987, with 144 (28%) of these cases resulting in a complete loss of service, and only 32 (6.2%) enjoying the initiation of new service.

The lack of services to these small communities continues even today. The EAS program which was supposed to sunset after ten years is still in effect after forty-four years.[211] Yet small communities are losing air service links to the rest of the country and numerous studies have identified that services and fares on shorter distances and less travelled city pairs have been adversely affected by deregulation.[212] In November 2021, SkyWest Airlines, the regional partner of United Airlines announced that it is ending operations at eleven small communities indefinitely from its hubs in Chicago, Denver and Houston. As a result, most of these cities lost half of their air connectivity.[213] This was followed by Delta Airlines cutting ties on seven routes indefinitely. Because of this move by Delta Airlines, three cities including Lincoln (Nebraska) Grand Junction (Colorado) and Cody (Wyoming) completely lost air services.[214] Recently in March 2022, United Airlines announced that its regional partner would be cutting services to another twenty-nine cities.[215] Similar withdrawal of services resulted in several cities having just one flight a day which earlier had two/three flights making it difficult to make further connections. Around thirty airports in the continental US have lost at least half the departures

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[207] Goetz & Dempsey, *supra* note 20 at 946.
[208] *Ibid* at 946.
[209] Paul Stephen Dempsey, *The Social and Economic Consequences of Deregulation: The Transportation Industry in Transition* (New York: Quorum Books, 1989) at 107.
[210] Goetz & Dempsey, *supra* note 20 at 947.
[211] Ben Baldanza, "The Essential Air Service Program is No Longer Essential" (21 March 2022), online: *Forbes* <https://www.forbes.com/sites/benbaldanza/2022/03/21/the-essential-air-service-program-is-no-longer-essential/?sh=27c9b1f06fda>.
[212] Goetz & Vowles, *supra* note 175 at 257.
[213] Taylor Rains, "Some of the Most Remote Areas in the US are Losing an Air Service Link to the Rest of the Country", *Business Insider* (20 November 2021), online: <https://www.businessinsider.com/small-communities-are-losing-air-service-rest-the-country-2021-11>
[214] Taylor Rains, "Delta will Stop Flying to 3 US Cities and Cut 7 Routes Indefinitely as Carriers Continue to Pull Out of Small Markets - See The Full List", *Business Insider* (13 December 2021), online: <https://www.businessinsider.nl/delta-will-stop-flying-to-3-us-cities-and-cut-7-routes-indefinitely-as-carriers-continue-to-pull-out-of-small-markets-see-the-full-list/>
[215] Taylor Rains & Gabrielle Bienasz, "United is Cutting 29 Cities this Summer Indefinitely Because its Partner Skywest Airlines Doesn't Have Enough Pilots to Fly The Routes - See The Full List", *Business Insider* (11 March 2022), online: <https://www.businessinsider.com/united-partner-skywest-dropping-29-cities-2022-3>

they had in 2019.[216] Therefore, in terms of air service, popular routes benefitted from deregulation, and small communities were adversely affected despite statutory provisions.

6.4.4. Airfares

The biggest driving force for deregulation was that competition and market forces would keep a check on pricing and airfares. In fact, it was believed that competition would bring down fares compared to the fares during regulations. However, as mentioned earlier, instead of increased competition, deregulation led to market concentrations and now the oligopolies are in a position to exploit passengers given the absence of price regulation.

Most of the price reductions that the industry saw in the initial years of deregulation were in the form of discounted fares with time restrictions, advance purchase requirements, and non-refundability provisions.[217] In fact, in relative terms, full fares rose 156% between 1978 and 1988 which is twice the rate of growth of the Consumer Price Index in the same period.[218]

Notwithstanding the overall increase in fares, large and medium markets witnessed the benefits of deregulation is the form of actual fare reductions.[219] But in the later years, fares on popular routes also increased. It was found that fares, in seven of the nine hub airports studied, increased at a rate faster than the Consumer Price Index between 1985 and 1988. It was estimated that flights originating or destined for a hub were priced 50% more than they would have been if the market was not deregulated.[220] Therefore the question arises what explains higher fares even on popular routes which were supposed to have higher competition? Prof. Dempsey explained that 'carriers adopting particular cities as hubs have increased frequencies and leased more gates, while incumbent airlines have quietly exited in favour of market dominance opportunities of their own in other hub airports.'[221] Therefore, due to limited airport resources like gates and slots, one or only a few carriers could make an airport its hub and consequently that airline enjoyed a monopoly on routes to or from that hub airport thereby limiting competition even on popular routes. At the same time, small communities or routes where there

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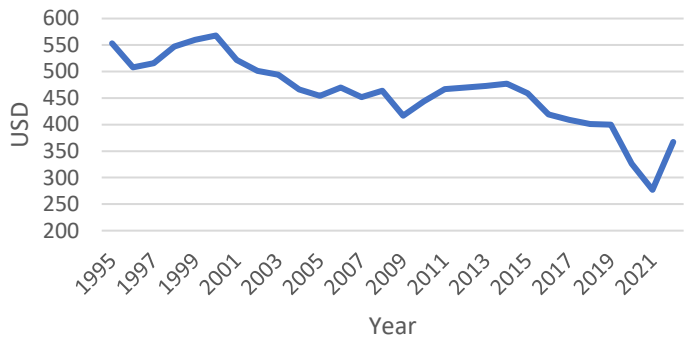
[216] Alison Sider & Allison Pohle, "Want to Fly This Summer? Good Luck Traveling to a Small City" (07 June 2022), online: *The Wall Street Journal* <https://www.wsj.com/articles/airlines-fewer-flights-small-cities-pilot-shortage-11654611718>
[217] Dempsey, "Laissez-Faire Mythology", *supra* note 46 at 356.
[218] *Ibid* at 356.
[219] IATA, *Aviation Deregulation - U.S. Domestic Deregulation Concepts and their Potential Application to International Aviation* (1984) at 8.
[220] William Stockton, "When Eight Carriers Call the Shots", *The New York Times* (20 November 1988), online: <https://www.nytimes.com/1988/11/20/business/when-eight-carriers-call-the-shots.html>
[221] Goetz & Dempsey, *supra* note 20 at 940.

was limited competition saw a rise in fares. Some routes even witnessed a 300% increase in fares between 1978 and 1988.[222]

After the initial increase in real fares, average fares on popular routes however have seen some decline post-1993.[223] And since then, average fares have continued to trend downward. According to a study by Brookings Institute, real fares in 2011, were almost 40% lower than the Standard Industry Fare Level.[224] The following chart shows the annual US domestic average airfares, adjusted for inflation.

Chart 1.3: Annual US Domestic Average Fare - Adjusted for Inflation (1995-22)



Source: Bureau of Transportation Statistics, US

The reduction is due to the rapid growth of LCCs which offers lower fares. In response to the growing demand for LCCs, the major carriers have segmented their passengers into more discreet cost categories based on comfort and amenities.[225] There has also been an increase in the number of classes of fares. For example, in 2015, Delta Airlines, American Airlines and United Airlines introduced basic economy fares, to cater to price-sensitive customers. While this resulted in reduced fares, it came at the cost of less comfort and amenities.[226] Passengers willing to pay premium airfares still enjoy the comforts associated with the early days of jet travel, but for other economy-class passengers, air travel has become less and less comfortable. Airlines focus on cost reduction and as a result, economy passengers suffer from tight seating, tiny restrooms, packed rows, and minimal service.[227] Additionally, there is also a decline in service quality in the form of delays and schedule uncertainties.[228] Despite the overall reduction in fares in the later years of deregulation, the benefits of price competition are unequally distributed with passengers on popular routes benefiting and small communities suffering.

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[222] Martha M Hamilton, "Is the Airline Industry. On the Verge of Going Global", *The Washington Post* (11 December 1988), online: <https://www.washingtonpost.com/archive/business/1988/12/11/is-the-airline-industry-on-the-verge-of-going-global-analysts-say-next-round-of-mergers-may-create-international-megacarriers/9386a0c0-c5a1-4752-a2a8-acf46ed790c2/>
[223] Goetz & Vowles, *supra* note 175 at 254-55.
[224] Nancy L Rose, *40 Years of Airline Deregulation: Success and Surprises* (Washington D.C.: Brooking Institute, 2018) at 8.
[225] *FAA Aerospace Forecast: Fiscal Years 2019-2039*, *supra* note 194 at 14.
[226] *Ibid* at 14.
[227] Peterson, *supra* note 190 at 16-17.
[228] Dempsey, "Laissez-Faire Mythology", *supra* note 46 at 360.

As seen from the above discussion, the benefits of deregulation were not immediate. On the contrary, in the initial years after deregulation, airfares increased, and the market witnessed numerous bankruptcies along with cynical cycles of profit and loss with the degree of losses increasing in every cycle. Smaller communities lost air services. The only immediate benefit of deregulation was the increased number of carriers on a given route due to new entries and incumbents expanding their operations which positively affected domestic passenger traffic. It took more than ten years since deregulation for reals fares to start reducing on popular routes and more than thirty years for the market to consolidate and consistently generate profits. It took the US airline industry years to reap the true benefits of liberalisation and even after forty years, while most assessments of deregulation have been positive, connectivity to remote parts still suffers.

7. International Air Transport Liberalisation

Notwithstanding the success or failures of domestic deregulation, the US Congress turned its focus outwards to international aviation.[229] Domestic US deregulation was within the sole unilateral competence of the US government. However, with respect to international deregulation, much of the US's reformist outlook was curtailed by the protectionist approach of the governments of other States. The US had already got a taste of it, first when countries voted against multilateral trading of traffic rights and later with UK's shift from a partially liberal Bermuda I Agreement to a more rigid Bermuda II Agreement.[230] But determined to export its liberal aviation policies to international aviation, the US passed the International Air Transport Competition Act of 1979 (IATCA)[231] which amended the Federal Aviation Act of 1958.

7.1. International Air Transport Competition Act of 1979 (IATCA)

The International Air Transport Competition Act seeks 'to institutionalize the progressive policy and cooperation which the United States is today practising.'[232] As obvious, the impact of the act is one-dimensional as it only mandates the US approach to negotiating bilateral agreements. It is therefore a 'unilateral declaration to deregulation' of international aviation.[233] The act stresses on pro-competitive policies with concerns for fair competition and non-

[229] Havel, *supra* note 23 at 268.
[230] See chapter 1, para 4.1 & 4.3.2, *above.*
[231] *International Air Transport Competition Act*, Pub. L. No. 96-192, 94 Stat. 35 (1980) (codified and later recodified in scattered sections of 49 U.S.C.) [*IATCA*].
[232] Legislative history, International Air Transport Competition Act of 1979, Reported to Senate from the Committee on Commerce, Science, and Transportation with amendment, S. Rept. 96-329 (1979) at 55.
[233] Havel, *supra* note 23 at 273.

discriminatory practices.[234] This statute was a response to UK's twelve months' notice to abandon the semi-liberal Bermuda I Agreement and shift to a rigid bilateral agreement. The step by the UK stimulated the US to seek more liberal pro-competitive agreements elsewhere with other governments.[235] With this intention, the IATCA was passed with the aim to:[236]

- Place maximum resilience on competitive market forces and on actual and potential competition.
- Allow carriers to offer fares based on consumer demand.
- Have fewer restrictions on charter services.
- Eliminate operational and marketing restrictions.
- Increase the number of non-stop US gateway cities.
- Allow foreign carriers to increase access to US points on a reciprocal basis.
- Eliminate discriminatory and unfair competitive practices faced by US airlines.
- Promote, encourage and develop a viable privately owned US air transport industry.

As evident, the IATCA aims to provide a framework of broad principles to the US negotiator while negotiating ASAs with foreign governments. It sets forth a clear pro-competitive mandate for negotiators to encourage liberalisation in the international market and thereby adopts new standards for foreign air transportation. With its twin objective – reliance on competition and enhancement of the competitive position of US carriers - IATCA is faithful to its domestic predecessor by superseding the older regulatory standard of 'competition to the extent necessary to assure the sound development of air transportation.'[237] However what differentiates IATCA from Airline Deregulation Act is that the former puts reliance on 'pragmatic goal-setting, what might be called *soft legislation*, as opposed to the hard provisions that predominate in the [Airline Deregulation Act].'[238] It goes without saying that the ultimate legal relationship between the US and foreign governments would be governed by the provisions of the ASAs and not the IATCA.

Apart from the soft provisions that guide US administrators in negotiating ASAs, the act grants certain hard powers aimed at protecting US carriers from unfair competitive advantages of foreign carriers. Accordingly, the CAB (now the DOT) with the approval of the President has the power to suspend or modify foreign air carriers' permits without a hearing if it is found that

[234] Brenner, Leet & Schott, *supra* note 202 at 12.
[235] *Ibid* at 13.
[236] *IATCA, supra* note 231, s 17(b) (codified as 49 U.S.C § 40101).
[237] Havel, *supra* note 23 at 274.
[238] *Ibid*.

the foreign government or foreign carrier has 'impaired, limited, or denied the operating rights of United States air carriers or engaged in unfair, discriminatory or restrictive practices with a substantial adverse competitive impact upon United States carriers, with respect to air transportation services to, from, through, or over the territory of such country'[239]

The IATCA also has provisions on anti-trust regulations governing foreign air transportation including intercarrier agreements between the US and foreign airlines. The legislation subjects intercarrier agreements like cooperative marketing alliances or code-share arrangements to optional filing procedures and merger standards applied to domestic agreements until 1989.[240] However unfiled agreements in foreign air transportation are governed by general anti-trust review like domestic agreements post-1989.[241] Unlike the power to review domestic anti-trust agreements of the CAB and later the DOT, which was sunset after 1989,[242] the power to review and grant immunity to foreign anti-trust agreements was not affected and to date continues to apply to foreign air transportation.[243]

The law for reviewing such agreements as it stands today is that the DOT first determines whether the agreement is adverse to the public interest because it could substantially reduce or eliminate competition (the 'competitive analysis').[244] If the question is answered in affirmative, anti-trust immunity would only be granted[245] if it is necessary to meet a serious transportation need or to achieve important public benefits[246] and such public benefits cannot be met or achieved by reasonably available and materially less anticompetitive alternatives.[247] If however the agreement is not found to be adverse to the public interest, then anti-trust immunity is granted[248] if there are public benefits to granting the immunity (public benefit analysis).[249]

7.2. Open Skies Agreements

After the setback with the UK, the US was desperate to negotiate liberal ASAs with foreign governments. In response, the US concluded its first liberal ASA (open skies) with The

[239] *IATCA*, *supra* note 231, s 9 (codified as 49 U.S.C. § 1372, recodified as 49 U.S.C § 41304 (b)).
[240] *Ibid,* s 11 (codified as 49 U.S.C. § 1382, recodified as 49 U.S.C § 41309).
[241] Havel, *supra* note 23 at 286.
[242] See chapter 1, para 6.3.3, *above.*
[243] 49 U.S.C. § 1384, (recodified as 49 U.S.C § 41308).
[244] 49 U.S.C. § 41309(b).
[245] 49 U.S.C. § 41308(b).
[246] 49 U.S.C. § 41309 (b)(1)(A).
[247] 49 U.S.C. § 41309 (b)(1)(B).
[248] 49 U.S.C. § 41309 (b).
[249] 49 U.S.C. § 41308 (b).

Netherlands[250] and thereafter with Belgium.[251] These liberal ASAs with the Benelux countries feature pricing flexibility, unrestricted capacity, multiple designations, access to interior US markets for foreign-flag carriers, new fifth freedom rights[252], country-of-origin charter rules, and elimination of discrimination and unfair methods of competition.[253] The Benelux model allows infinite designations.[254] On capacity, States have pledged to avoid limiting the frequency of capacity.[255] States have also agreed to eliminate discriminatory and unfair competitive practices and provide for just, reasonable and non-discriminatory user charges.[256] However, it must be noted that even though these bilateral ASAs are liberal in nature, initially complete freedom was not granted to airlines on pricing. States followed either a system of 'country of origin pricing' wherein fares may be unilaterally *disapproved* by the State where the flight originates from or a system of 'double disapproval' wherein carriers could determine fares unless both the States disapprove them.

After the initial success with the open skies agreements, the US negotiated and signed eleven new open skies Benelux-type agreements or amended existing agreements. Through these open skies agreements, the US embraced an attitude of 'let's stick it to the Brits -let's put pressure on the Germans through Amsterdam'.[257] Their strategy was to 'divide and conquer.'[258] Since the US is the largest passenger market in the world, by giving liberal traffic freedoms to carriers of States with which they had open skies ASA, the US lured other countries to negotiate liberal ASAs. By the mid-1980s more and more countries joined the list with which the US had liberal ASAs. Even the US-UK Bermuda II Agreement was liberalised to a certain extent.[259]

In 1992, the US once again wanted to further liberalise the ASAs. As usual, it found the Dutch to be its willing partner. A Memorandum of Consultations (MoC) was signed between the US and The Netherlands which further liberalised the 1978 open skies agreement.[260] This new arrangement now allows the Dutch carriers to fly to and from anywhere they choose to in the

[250] *Protocol Amending the Air Transport Agreement of 1957*, United States and The Netherlands, as amended 31 March 1978, TIAS No 1507.
[251] *Agreement Amending the Air Transport Services Agreement of 1946*, United States and Belgium, as amended 12-14 December 1978, TIAS No 9207.
[252] See appendix, *below.*
[253] Dempsey, *Public Air Law, supra* note 9 at 668-69.
[254] *Ibid at 677.*
[255] *Ibid* at 678.
[256] *Ibid* at 678.
[257] Sampson, *supra* note 84 at 145.
[258] Dempsey, *Public Air Law, supra* note 9 at 673.
[259] *Ibid* at 676.
[260] *Memorandum of Consultations concerning the US-NL Open Skies Agreement* (1992).

US with US carriers getting reciprocal rights in The Netherlands.[261] The pricing restriction was replaced with free pricing with an exception to predatory pricing.[262] From 1992 till today, this kind of open skies agreement has become the new norm and the US alone has signed more than one hundred and thirty open skies agreements with partner nations.[263] The basic elements of an open skies agreement as identified by the DOT are open entry on all routes, unrestricted capacity and frequency, unrestricted route and traffic rights, double-disapproval pricing mechanism, liberal charter and cargo regime, convenient currency remittance and conversion options, open code-sharing opportunities, self-ground-handling provisions, and explicit commitment for the non-discriminatory operation of and access to computer reservation systems.[264]

Noteworthily, irrespective of these freedoms, certain restrictions are still in place, the most important ones being restrictions on seventh freedom and cabotage[265] and nationality rules linked to substantial ownership and effective control.[266]

7.3. Effects of International Deregulation in the US – The Bad and the Good

7.3.1. The Bad

In the early years of the era of open skies, the US carriers vehemently opposed the US international air transport liberalisation. They objected to the trading of 'hard rights' (access to major United States interior markets) for 'soft rights' (theoretical access to foreign markets, imprecise promises for liberal pricing opportunities, and prohibition against discrimination and unfair competitive practices) in the Benelux type open skies agreements.[267] Access to the lucrative US international routes by foreign carriers led to a decrease in the market share of the US carriers instead of increasing the market size.[268] Prior to the Benelux-type agreements, US traffic from the interior markets would be flown to international hub airports like New York, San Francisco, Los Angeles or Miami by US carriers (due to cabotage restrictions). Data shows that most US passengers who began their international journey with US carriers would prefer to continue the international wing of their journey from the hub with US carriers.[269] But since

[261] Pablo Mendes de Leon, "Before and After the Tenth Anniversary of the Open Skies Agreement Netherlands-US of 1992" (2002) 27:4/5 Air & Space L 280 at 289.
[262] *Ibid* at 289.
[263] "Open Skies Partnerships: Expanding the Benefits of Freer Commercial Aviation" (16 September 2016) online: *U.S. Department of States* < https://2009-2017.state.gov/r/pa/pl/262022.htm>
[264] US, DOT, *In the Matter of Defining 'Open Skies'* Order 92-8-13 (1992).
[265] *Ibid,* art 2(4); See appendix, *below.*
[266] *Ibid,* art 3(a) & 4(1)(b).
[267] Dempsey, "Deregulation of International Air Transport", *supra* note 116 *at* 356.
[268] *Ibid* at 360-61.
[269] *Ibid* at 358-61.

foreign carriers were given direct access to the interior markets, these advantages were diluted. For example, KLM was able to offer direct flights to Amsterdam from Boston, Houston, Atlanta etc. Even though US carriers had the right to do the same and the US was free to designate an unlimited number of carriers, KLM had strategic advantages over the US carriers (like a hub in Amsterdam, pooling agreement, market identity and local traffic fill-ups).[270] With US entry into Benelux-type agreements with other nations, 'the US airline share of [the international] market [was] reduced by significantly increased foreign airline access to the US market.'[271]

Furthermore, it is important to recognise that US carriers even today do not have the same level playing field everywhere in the international market as they do in the domestic market. In the domestic market, the US has no government-owned carrier, and all domestic carriers are subject to the same competitive practices. With respect to international services, many foreign carriers are operated by the government for the purpose of enhancing prestige rather than open market economic principles. Most of these carriers depend on the government for operating costs rather than simply on profits. On the other hand, US carriers that are unable to be profitable face the risk of bankruptcy. Moreover, US carriers face several anti-competitive practices on foreign soil including discriminatory airport, navigation services and user charges, preferential customs and immigration services, discriminatory fuel charges, ground handling service restrictions, discriminatory computer reservation systems, discriminatory taxes, inferior facilities and restrictions on currency remittance.[272]

In recent times, US carriers are facing similar practices from the Gulf carriers (Qatar Airways, Emirates and Etihad Airways). As per reports, United Arab Emirates (UAE) and Qatar have provided USD 50 billion in subsidies and other benefits to their carriers in violation of the open skies agreement for fair competition.[273] Each of the Gulf carriers has built an enormous large fleet of the most modern aircraft for competitive use allegedly with the help of the federal treasury.[274] As a result, today Emirates is the largest carrier by capacity although not the largest in revenue.[275] US carriers have lost passenger market share from 49% in 2010 to only 10% in

[270] *Ibid* at 360.
[271] Brenner, Leet & Schott, *supra* note 202 at 113.
[272] Paul Stephen Dempsey & Laurance E Gesell, *Public Policy and the Regulation of Commercial Aviation* (Arizona: Coast Aire Publications, 2013) at 309-10.
[273] "Partnership for Open & Fair Skies and U.S. Airlines for Open Skies: The US Open Skies Debate" (2017) 73:2 Défense Transportation J 20 at 21.
[274] Thomas J Duesterberg, *Subsidies and Unfair Competition in Global Commercial Aviation: How to Respond* (Washington, D.C.: Hudson Institute, 2018) at 4.
[275] *Ibid.*

2021 on the US-Middle East route.[276] Due to the sixth freedom rights[277] enjoyed by the Gulf carriers, US carriers also lost global market shares of international passengers. For example, the Gulf carriers used their geographically convenient hub to increase their market share for US-India passengers from 8% in 2008 to 46% in 2016 and US carriers lost one-third of their passengers on this route.[278]

Frustrated by the anti-competitive practices, in 2016 the three big US carriers wrote to President Trump about the massive unfair subsidies that the UAE and Qatar give to their State-owned carriers and appealed for protection against foreign competition.[279] However, Emirates rebutted these allegations and claimed that 'the subsidy allegations put forward by the Big 3 [American carriers] are patently false. We have been profitable for 27 years straight, and unlike our accusers, we have never depended on government bailouts or protection from competition.'[280] Therefore, given the uncompetitive practices of some States, the international air transport liberalisation promulgated by the US failed to achieve its desired results of a market free from government interference on certain routes.

7.3.2. The Good

Notwithstanding the anti-competitive practices and unlevel playing field faced by US carriers, international air transport liberalisation has its benefits as well, particularly the effects of immunised airline alliances on traffic and fares. Two reports by the DOT on the impact of airline alliances on the transatlantic market between the US and Europe conducted in 1999[281] and 2000[282] have shown open skies agreements and immunised airline alliances give airlines the operating flexibility to improve efficiency and services and afford price flexibility needed to develop competing pricing strategies and market them effectively.[283] Moreover, international liberalisation has paved the path for an increased number of strategic partnerships between US and foreign airlines which has allowed the airline industry to provide better

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[276] US, DOT, *US International Air Passenger and Freight Statistics, September 2021* (Office of the Assistant Secretary for Aviation and International Affairs, 2022) at table 2.
[277] See appendix, *below*.
[278] Duesterberg, *supra* note 274 at 6.
[279] Ashley Halsey III, "U.S. Airlines Plan Appeal to Trump for Protection Against Foreign Competition", *The Washington Post* (10 November 2016), online: <https://www.washingtonpost.com/local/trafficandcommuting/us-airlines-plan-appeal-to-trump-for-protection-against-foreign-competition/2016/11/09/2c125902-a6b4-11e6-8fc0-7be8f848c492_story.html>
[280] "Emirates Debunks Subsidy and Unfair Competition Allegations" (30 June 2015), online: *Emirates* <https://www.emirates.com/media-centre/emirates-debunks-subsidy-and-unfair-competition-allegations/>
[281] US, DOT, *International Aviation Developments: Global Deregulation Takes Off* (First Report, 1999) [*Global Deregulation*].
[282] US, DOT, *International Aviation Developments: Transatlantic Deregulation – The Alliance Network Effect* (Second Report, 2000) [*Transatlantic Deregulation*].
[283] *Ibid* at 2.

quality, lower priced, more competitive service for millions of passengers in thousands of international city-pair markets.[284]

Historically a vast majority of international markets were underserved due to restrictions on operations under the restrictive bilateral ASAs and lack of competition.[285] Furthermore, it is not possible for an airline, however strong, to provide services to every destination its customers require. It is virtually impossible, even today to have the benefit of non-stop services between every city-pair and they can indeed only be served by connecting services. Airline alliances are the only practical way to provide improved and competitive services between these city pairs.[286] These partnerships allow airlines to link their networks and capture the enormous efficiencies of a larger network and provide services to a wider array of city pairs.[287]

The benefits of alliances prompted several airlines to apply for anti-trust immunity. In 1993, DOT gave Northwest and KLM anti-trust immunity, and this alliance began to draw traffic from other European hubs.[288] Several other carriers sought similar immunities including Delta Airlines/ Swissair/ Australian Airlines/ Sabena/ Virgin American/ Canadian Airlines/ United Airlines/ Lufthansa/Air Canada. Except for American Airlines and British Airways union, most major alliances were granted immunity.[289] The DOT believed anti-trust immunity to be a *quid-pro-quo* to attain market liberalisation through open skies agreements.[290]

These immunised alliances paid off and played a key role in evolving the international aviation economic and competitive environment. The reports by the DOT mentioned earlier have shown that liberalisation leads to increased demand and traffic growth, reduced fare, expanded network and improved services.[291] The reports studied the total number of passengers flowing between the US and European cities for the years 1992 through 1999 and revealed that traffic grew at a rate of about 5% per year through 1995, but the rate sharply increased in 1996 and then accelerated in 1997 and 1998.[292] It was concluded that the primary reason for the steep increase post-1995 was due to the presence of three immunised alliances of which two were granted immunity in 1996.[293] To emphasise on the role of alliances, the study also compared

[284] *Transatlantic Deregulation*, *supra* note 282 at 1.
[285] *Global Deregulation*, *supra* note 281 at 4.
[286] *Ibid.*
[287] *Ibid.*
[288] Dempsey, *Public Air Law, supra* note 9 at 687-88.
[289] *Ibid* at 688-89.
[290] *Ibid.*
[291] *Transatlantic Deregulation*, *supra* note 282.
[292] *Global Deregulation, supra* note 281 at 6.
[293] *Ibid.*

the passenger traffic of the three alliances and other non-allied airlines. It was seen that in 1999, the traffic share of the alliances was 56% higher than the non-allied airlines on the transatlantic routes.[294] Moreover, the overall increase in passenger traffic over the years proved that not all passengers were diverted from other carriers and indeed, most of the traffic growth of alliances was due to new and increased passenger traffic.[295]

The report also observed that average fares with open skies countries declined by 20.1% between 1996 and 1999 whereas fares only reduced by 10.3% with non-open skies countries in the same period.[296] It was concluded that open skies agreements leading to the creation of alliances and code-share agreements have enabled airlines to offer better pricing on connecting routes which airlines are reluctant to do on a purely interline basis.[297] Moreover, growing alliances have created an ever-increasing number of overlap markets and increased the number of carrier presence on any particular connecting city pairs due to carriers being able to significantly expand market access with the help of their allied partners which otherwise would not have been possible for an individual airline. This increases the supply and competitive pressure, leading to reduced fares.[298]

Given the benefits of international liberalisation, the US continued pursuing negotiation of open skies agreements with its foreign counterparts and due to these efforts and in light of the general trend towards liberalisation, the number of US's open skies partners increased from merely thirty-six in 2000 to more than one hundred and thirty as of today.[299] These efforts have led to a significant increase in US international passenger traffic which rose from one hundred and forty-two million in 2000 to two hundred and forty-four million by the end of 2019, an increase of more than 70% in two decades.[300] Moreover, after the initial period of losing market share and financial difficulties, US carriers emerged competitive and since 2000 till date, they have successfully maintained a yearly market share between 48-57% of the US's international passenger traffic.[301] Therefore, apart from a few anti-competitive practices that US carriers have to face due to the protectionist approach of some countries towards their flag carriers, the journey of international liberalisation has been more or less a success.

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[294] *Transatlantic Deregulation*, *supra* note 282 at 4.
[295] *Global Deregulation, supra* note 281 at 8.
[296] *Transatlantic Deregulation*, *supra* note 282 at 3.
[297] *Global Deregulation, supra* note 281 at 13-14.
[298] *Transatlantic Deregulation*, *supra* note 282 at 4.
[299] "Open Skies Partners" (28 April 2021) online: *U.S. Department of State* <https://www.state.gov/open-skies-partners/>
[300] US, DOT, *U.S. International Air Passenger and Freight Statistics* (Various years between 2000 and 2019).
[301] *Ibid.*

8. Global Trend towards Liberalisation

As evident from the above discussion, in later years, ASAs became less rigid through the practical cooperation of states, the integration of their economies and their political institutions gradually permitting a flexible and more cooperative understanding and application of the concept of complete and exclusive sovereignty. However, it is the sovereign right of states to freely accept restrictions on their sovereign rights for mutual benefits.[302] Therefore, the extent of regulations depends on the willingness of both governments to have a free market.

While the US was the mastermind behind air transport liberalization, it started a global trend towards it. The United Nations body on civil aviation - ICAO - which is responsible for fostering the development of international air transport has taken steps in an effort to form a global consensus on liberalising the air transport industry. In 2003, ICAO organised the 5th Worldwide Air Transport Conference on 'the Challenges and Opportunities of Liberalization.'[303] The objective of the conference was 'to develop a framework for the progressive liberalization of international air transport with safeguards to ensure fair competition, safety and security and including measures to ensure the effective and sustained participation of developing countries.'[304] The focus of the conference was not to decide whether to liberalise, rather it emphasised how to liberalise. Widespread support was gained for a 'gradual, progressive and safeguarded liberalization'[305] and the conference adopted a declaration wherein it was affirmed that:

> States should, to the extent feasible, liberalize international air transport market access, air carrier access to international capital and air carrier freedom to conduct commercial activities.[306]

The 6th Worldwide Air Transport Conference held in 2013 also focused on similar issues of liberalisation.[307] In conclusion, the global trend towards liberalisation in the air transport industry has been gaining momentum with the cooperation of States and international bodies such as the ICAO and the industry is poised to become more consumer-centric and competitive.

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[302] Michael Milde, "The Chicago Convention - Are Major Amendments Necessary or Desirable 50 Years Later?" (1994) 19:1 Ann Air & Sp L 401.
[303] ICAO, *Worldwide Air Transport Conference: Challenges and Opportunities of Liberalization* ATConf/5-WP/21 (Montreal: 24-29 March 2003).
[304] *Ibid* at 6.
[305] *Ibid* at 6.
[306] ICAO, "Consolidated Conclusions, Model Clauses, Recommendations and Declaration" (Worldwide Air Transport Conference: Challenges and Opportunities of Liberalization, 31 March 2003) at Declaration, para 4.5.
[307] ICAO*, Sixth Worldwide Air Transport Conference: Sustainability of Air Transport* ICAO Doc 10009 (Montreal: 18-22 March 2013).

CHAPTER 2: HISTORY AND INDIA'S JOURNEY TO DEREGULATION

Increasing economic globalisation across different industries including the civil aviation industry had gained significant pace since the 1970s. This posed enormous challenges of adjustment and adaptation for less developed and developing countries like India. India's position in industrialisation till the late 1980s corresponded to most third-world countries where the State was the sole agent responsible for the nation's economic development. The State's responsibility was justified by the ideologies of socialism wherein industries were mostly public sector or there were rigid controls over the private sector. In the field of aviation, the industry was nationalised and consolidated into two corporations as early as 1953. From nationalisation to deregulation and ultimately privatising the government carrier, India has come a long way, keeping pace with global liberalisation trends. This chapter provides a discussion of India's civil aviation journey from the pre-independence era to nationalisation and finally to liberalisation with a particularly important discussion on the factors that motivated the government to go down the path of liberalisation.

1. History: Pre-Independence Era

There was no development in air transportation in India till 1910. In the following year, when India was still under the British rule, an arrangement was made by the Post and Telegraphs Department of the Government of India (British India) to fly an aeroplane labelled 'First Aerial Post, United Provinces Exhibition Allahabad, 1911' carrying mail for a distance of six miles from Allahabad to Naini.[308] Along with India's first flying activity, India also got its first legislation governing air transport in the same year – The Indian Airships Act 1911[309] – which regulated the 'manufacture, possession, use, sale, import and export of airships'[310] and granted licenses in this regard.[311] The Act gave rule-making powers to the Governor General in Council and Local Governments to make rules under which licenses may be granted.[312] The Governor General also had the power to prohibit or restrict the import and export of airships[313] as well as to cancel and suspend licenses.[314] It was extraordinary that such a regime of licensing and regulations was introduced as early as 1911 in India; however, it must be noted that the licensing provisions did not concern scheduled airline operations in a modern sense, but rather

[308] Malhar Ramchandra Dhekney, *Air Transport in India, Growth & Problems* (Bombay: Vora, 1953) at 54.
[309] *Indian Airships Act 1911,* Act No. XVII of 1911 (India) [repealed].
[310] *Ibid,* preamble.
[311] *Ibid,* s 3.
[312] *Ibid,* s 3.
[313] *Ibid,* s 4.
[314] *Ibid,* s 5.

a general licensing regime to regulate the manufacture, possession, use, sale, import and export of aircraft. Some commentators viewed this act as premature as there was neither regular flying activity nor the manufacture of aircraft in India at that time.[315]

Two years later in 1913, an air exhibition was organised in Calcutta where two aeroplanes flew over the river Hooghly. The purpose of the event was to create awareness and interest among Indians in flying.[316] However, the event failed to trigger any interest in research and development in India.[317] During the negotiations of the Paris Convention, 1919, the British Government decided to treat India as a Dominion in accordance with the Declaration of Imperial Conference of 1917 to give India a seat at the negotiation table and become a signatory.[318] Thereafter, in 1919, the British Government was concerned about linking India to other parts of the British Empire. The first proposed international service was Cairo-Baghdad -Karachi (formerly part of British India, now part of independent Pakistan); however, due to the unsettled conditions in Arabia and Iraq, the offer was not accepted.[319] Later, in 1922, the importance of air connectivity to different sectors of the British Empire was re-emphasised and in 1924 Imperial Airways Limited was incorporated in the UK.[320] Soon after the inauguration of Imperial Airways, the Air Ministry signed an agreement in 1924 to inaugurate services between Cairo and Karachi as the first link between British territories involving India.[321] The service started only in 1929 due to the initial refusal of the Persian Territory to permit Cairo-Karachi operations over Persian territory. On 30 March 1929, the first international flight reached Karachi from England with passengers and mail and the route followed was London-Paris-Basle-Genoa-Rome-Naples-Corfu-Athens-Soudabay-Tobruk-Alexandria-Gaza-Baghdad Basra-Bushire-Lingeh-Jask-Gwadar-Karachi.[322]

1.1. The Indian Air Board

The Indian Air Board was set up in India as early as 1920 under the Department of Commerce and Industry[323] but it stayed dormant in its initial years. In 1926, the Board submitted a

[315] Uthej Vattipalli, "Aviation Law and Carrier Liabilities in India" (2020) 48 Transportation Research Procedia 60 at 61.
[316] P K Menon, *History, Law and Government Control of Civil Aviation in India* (LLM Thesis, McGill University Institute of Air and Space Law, 1967) [unpublished] at 12.
[317] *Ibid* at 12.
[318] *Paris Convention*, *supra* note 77, preamble.
[319] Dhekney, *supra* note 308 at 55.
[320] A J Quin-Harkin, "Imperial Airways, 1924-40" (1957) 4:1 The J Transport History 197 at 197.
[321] *Ibid* at 203.
[322] B S Gidwani, *History of Air Transport* (New Delhi: Suneja Book Centre, 1954) at 66.
[323] India, Air Ministry, *Half-Yearly Report on the progress of Civil Aviation October 1, 1919 to March 31, 1920* (1920).

memorandum titled 'Past History and Future Development of Civil Aviation in India'.[324] Among other things the memorandum suggested taking steps to prevent the fall of air transport in India into foreign hands. The Board encouraged Indian officials to take active steps to develop the aviation industry in India.[325] The recommendations of the Board were approved by the Government in 1927. At the same time, Indian leaders in the legislative assembly stressed on developing flying clubs in India to enhance knowledge of aviation along with providing adequate opportunities for training and employment.[326]

1.2. Indian State Air Service

With the introduction of international air routes, especially London-Karachi, and the stress on developing aviation in India, a need was felt to extend air services within the country, particularly to Delhi – the seat of the government. However, at that time, India lacked the financial and technical resources to operate its own airline.[327] Allowing any foreign carrier to fly on domestic routes would violate the Indian Air Board's recommendations which had been adopted by the government. To avoid this legal barrier, the British India government entered into a charter agreement with Imperial Airways wherein the aircraft would be chartered by the government and Imperial Airways would retain technical and operational control.[328] Under this arrangement, service on the Karachi-Delhi route started in December 1929 and was called the 'Indian State Air Service'.[329] In this period, the Indian Inter State Air Service completed one hundred and ninety-seven scheduled flights carrying two hundred and thirty-six passengers and more than fourteen thousand pounds of mail.[330] As evident from the arrangement, India's first domestic air travel was virtually operated by the government. This arrangement was, however, terminated after two years due to opposition to the arrangement in the Legislative Assembly. It was argued that Indian funds were used to support a foreign airline - Imperial Airways - and that the agreement with Imperial Airways did not provide for training or associating Indian personnel in their operations.[331]

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[324] Pran Nath Seth, *Successful Tourism Management: Tourism Practices,* vol 2 (New Delhi: Sterling Publishers Private Limited, 2006) at 92.
[325] Menon, *supra* note 316 at 17.
[326] *Ibid* at 17.
[327] *Ibid* at 18.
[328] Peter Lyth, "The Empire's Airway: British Civil Aviation from 1919 to 1939" (2000) 78 Revue belge de Philologie et d'Histoire 865 at 876.
[329] *Ibid.*
[330] Gidwani, *supra* note 322 at 67.
[331] Menon, *supra* note 316 at 19.

1.3. Development of Indigenous Domestic Airlines

To avoid a vacuum, in 1932 an arrangement was made with the Delhi Flying Club for the carriage of mail which only lasted for eighteen months. As per the arrangement, the government provided the flying club with aircraft and the club provided pilots for a fixed remuneration for each pound of mail carried.[332] During the period January 1932 to July 1933, when Delhi Flying Club was carrying mail, India's first indigenous scheduled airlines – Tata Airlines – began operations on 15 October 1932.[333] The first air transport service it provided was transporting mail that arrived on Imperial Airway's London Karachi route from Karachi to Bombay via Ahmedabad and then to Madras via Bellary.[334] Tata Airlines entered an agreement with the government for a period of ten years for the carriage of the mail at a fixed remuneration which was at a level covered by the surcharge collected by the Post and Telegraph Department.[335] Therefore the only source of traffic for Tata Airlines was surcharged mail. It provided weekly services with stops at Ahmedabad, Bombay and Bellary.[336] The airline had limited resources including just two aircraft, one full-time pilot, one part-time engineer and two mechanics.[337] Due to the limited resources and small aircraft, the airline only transported mail with occasionally one passenger seated on top of the mail bags.[338] By 1937, the airline had started new services between Bombay – Trivandrum via Goa and Cannanore and Delhi – Bombay via Indore, Bhopal and Gwalior;[339] however all these operations were commandeered by the Government during the World War II. Later in 1946, Tata Airlines was incorporated as a public listed company called Air India.

Similar to Tata Airlines, India's second private airline – Indian National Airways (INA) - began operations in 1933.[340] Unlike Tata Airlines which only transported air mail at that time, INA operated weekly air services carrying passengers, mail and freight. It started its operations on Calcutta-Rangoon (now in Myanmar) and Calcutta-Dacca (now in Bangladesh) routes in 1933[341] and even procured an undertaking from the government (similar to the contract between the government and Tata Airlines) that no other company would be given mail

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[332] J A Shillidi, "Civil Aviation in India" (1935) 83:4299 J Royal Society Arts 477 at 485.
[333] J R D Tata, "The Sixteenth British Commonwealth Lecture: The Story of Indian Air Transport." (1994) 66:6 Current Science 455 at 459.
[334] *Ibid* at 459.
[335] India, Ministry of Communications, *Report of the Air Transport Enquiry Committee 1950* (New Delhi: Government of India Press, 1950) at 4 [*Enquiry Committee*].
[336] *Ibid*
[337] Tata, *supra* note 333 at 459.
[338] "Wings for a Nation", online: *Tata* <https://www.tata.com/newsroom/wings-for-a-nation>
[339] Dhekney, *supra* note 308 at 71-72.
[340] *Enquiry Committee*, *supra* note 335 at 4.
[341] Shillidy, *supra* note 332 at 487.

contracts for carriage of mail between Karachi and Lahore that were brought by Imperial Airways service to Karachi.[342] The rate of remuneration for the carriage of mail was like that of Tata Airlines i.e. the surcharge that was levied on air mail with no subsidies. A third airline, Air Services of India was incorporated in 1937 to operate passenger services primarily from Bombay to the other Indian states but they closed operations within two years for not being profitable.[343] Tata Airlines and INA's profits and operations steadily grew over the years.[344]

1.4. The Empire Mail Scheme

In 1938 the British Government introduced the Empire Air Mail Scheme in India.[345] Prior to that, only mail that bore a surcharge was carried by air within India or between India and other countries. With the introduction of this scheme, all first-class mail between the Empire and commonwealth countries served by the UK-Australia and UK-Africa routes were to be carried by air without any surcharge.[346] In India, this scheme provided for transportation of mail by air within India that was brought by Imperial Airways up to Karachi or to bring to Karachi from within India mail destined to other parts of the British Empire. Tata Airlines and INA were already providing air mail services to and from Karachi and the government offered these carriers fifteen years contract with guaranteed minimum payments for the transportation of first-class mail under the scheme.[347] For Tata Airlines, the government agreed to pay Rs 1.5 million a year for carriage of mail of up to 500,000 lbs and Rs 1/lb for every extra pound of mail on the Karachi-Colombo route.[348] Similarly, a minimum payment of Rs 350 thousand per year for 130,000 lbs plus Rs. 1/lb for each extra pound of mail was agreed upon between the government and INA for the carriage of mail on the Karachi-Lahore route.[349] This allowed the Indian airlines to massively expand their operations and generate higher revenues.

However, the growth of Indian aviation slowed down during the World War II in 1939. Air transportation of mail was severely reduced and strict controls were imposed on passenger traffic. Resources from the Empire Mail Scheme and domestic air services were diverted for the purposes of the war and were used by the government for defence during the war.[350]

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[342] *Ibid.*
[343] Menon, *supra* note 316 at 23.
[344] Seth, *supra* note 324 at 93.
[345] *Enquiry Committee*, *supra* note 335 at 5.
[346] *Ibid.*
[347] *Ibid.*
[348] *Ibid.*
[349] *Ibid.*
[350] Menon, *supra* note 316 at 26.

1.5. Post-World War II – The Tymms Plans

During the end of the World War II, the government was keen on reconstructing and developing civil aviation in a modern sense in India. Sir Frederick Tymms – the then Director of Civil Aviation – was tasked with drafting a post-war plan for India. He submitted in September 1943 a series of papers on all aspects of civil aviation in India.[351] He drew up a list of trunk air routes that required the most attention from the government and also recommended 'essential links' between the trunk routes.[352] A third category of routes was also recommended – local air service' – keeping in mind local importance and interests.[353] Sir Frederick estimated that the total capacity in the post-war period in India would be seventeen million ton-miles a year which would require at least thirty-two aircraft with one thousand and seven hundred hours per aircraft per year. In his plan, he recommended entrusting a maximum of four scheduled airlines incorporated as private companies to fulfil the need.[354] Each airline would have adequate route mileage and scope for development to ensure the effective use of their aircraft. The companies would be provided indigenous subsidies. Each operator would operate on a commercial basis with the aim to recover costs and generate revenue. Those that would beat the target would generate profits and others would incur losses.[355]

A licensing regime was also recommended wherein scheduled airlines could not operate without licences from an autonomous licensing board.[356] However, there were no regulations or restrictions proposed by Sir Frederick on the operations or routes that could be served. But the choice was anyway limited given the inadequate ground service facilities. Noteworthily, there was no licensing regime in the pre-war period and the legislation i.e., the Indian Aircraft Rules only dealt with the technical requirements of air transport operations like licensing of personnel, registration of aircraft, certification of their airworthiness and their periodical inspections, licensing of aerodromes, etc. There was no requirement for licences that controlled the operations of air transport services and the routes of operations.

Sir Frederick's plans were approved by the Post-War Reconstruction Policy Committee for Posts and Aviation and the plan was officially adopted in the form of amendments to the Indian Aircraft Act 1934 and Rules to incorporate licensing for air transport services.[357]

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[351] *Enquiry Committee*, *supra* note 335 at 8.
[352] *Ibid.*
[353] *Ibid.*
[354] *Ibid* at 9.
[355] *Ibid.*
[356] *Ibid* 9-10.
[357] *Ibid* at 10.

1.6. The Air Transport Licensing Board

Prior to 1946, there was no requirement to obtain a licence. Even though the Indian Aircraft Rules was in force, it only regulated the technical aspects. Due to the small number of airline enterprises and limited resources at that time, the system worked well. Post-World War II, with an improvement in air transportation, government regulations also increased, and the Indian Aircraft Rules 1937 was amended. In accordance with the new policy, a licensing board was established in India. Scheduled operations post 01 October 1946 could only be set up after obtaining a licence from the Air Transport Licensing Board.[358] Interestingly, the provisions on licensing in India were enacted months before India became a party to the Chicago Convention (on 01 March 1947) which *inter alia* also deals with certification of personnel licensing and airworthiness for international air transportation.[359]

P. K. Menon aptly summarised the duties of the board with respect to granting licences:[360]

> [The board] had the authority and duty to examine applications for licences to operate air transport services, and of issuing, amending, suspending or revoking such licences. In granting or refusing to grant a licence, or in attaching conditions to a licence, the Board was authorized to exercise its discretion in terms of the need for air transport in the area concerned, potential traffic on the route, existing air services and the capacity of the applicant as an air transport operator.

However, in granting licences to carriers, the board ignored the most important recommendation of Sir Frederick, which was to have a maximum of four scheduled airlines.[361] There was a boom in the aviation industry in India due to the availability of large funds seeking investment and the huge availability of war surplus aircraft available at cheap prices. There was an impression that aviation was a profitable business, and these conditions gave an impetus to the floatation of aviation companies.[362] Even before the board began considering applications, twenty-one companies had already registered for licences and within six months of its operations, the board received more than a hundred applications for over ninety-six routes.[363] The board – ignorant of economic realities – believed that Sir Frederick underestimated the potential of the aviation industry in India and completely ignored his

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[358] Frederick Tymms, "Aviation in India" (1947) 1:4 Intl Air Affairs 462 at 470.
[359] See *Chicago Convention*, *supra* note 86 at art 29, 31, 32, 33 & 37.
[360] Menon, *supra* note 316 at 31.
[361] Tata, *supra* note 333 at 462.
[362] India, Planning Commission, *1st Five Year Plan 1951-1956* (New Delhi: 1951) at chapter 31, para 58.
[363] Tymms, *supra* note 358 at 471.

calculations.[364] By 1947, the board had granted licences to eleven companies on fifty-one routes.[365] These airlines lacked organisation, equipment, training and operational standards. Many of the routes on which licences were granted also lacked adequate traffic demands and their operations were uneconomical.[366] This led to airlines struggling for profits and their costs of operations also skyrocketed. This over-competition led to overcapacity, fare undercutting and bankruptcy in the following years.[367]

2. History: Post-Independence Era

India gained its independence on 15 August 1947. The period was characterised by political turmoil especially due to the unfortunate partition of the Republic of India and Pakistan. Partition caused a change in route patterns of airlines and the transfer of assets and activities of some airlines. For example, Orient Airways resettled in Pakistan and consequently abandoned several routes in India. Similarly, INA stopped operations in Pakistan.[368] However, partition brought about increased air transportation because of the mass migration triggered by communal unrest. More than ten thousand people were brought from Pakistan to India by the Indian carriers.[369] Partition also caused severe unrest on the Kashmir front. Indian carriers were involved in transporting food supplies and military personnel to Kashmir. Approximately seven hundred and fifty non-scheduled trips were made by Indian carriers from Delhi to Kashmir within a span of three weeks towards the end of 1947 carrying loads of more than sixty million pounds.[370] These events though unfortunate had partially relieved the airlines of the financial strains.

2.1. State Assistance

The turmoil created by the partition boosted air traffic and created an impression that commercial air traffic was profitable but gradually air transport started returning to normalcy.[371] With the return to normal civil traffic, airlines again found themselves in financial stress. With the passing days, the situation got worse. In 1948, Jupiter Airlines which operated on Delhi-Nagpur-Bezwada-Vizagapatam-Madras went bankrupt followed by Ambica Airlines which operated certain services in the Kathiawar area and on the Bombay-Poona-Bangalore

[364] Seth, *supra* note 324 at 95.
[365] Tata, *supra* note 333 at 462.
[366] Seth, *supra* note 324 at 95.
[367] Menon, *supra* note 316 at 33.
[368] *Enquiry Committee*, *supra* note 335 at 13-14.
[369] Gidwani, *supra* note 322 at 90.
[370] *Ibid.*
[371] *1st Five Years Plan*, *supra* note 362 at chapter 31, para 56.

sector in early 1949.[372] The industry was headed towards a complete breakdown when the government decided to step in.

To save and protect the industry, the government took immediate steps to rectify the situation. Firstly, the government permitted carriers to increase fares and payload of aircraft.[373] Secondly, the government offered a partial rebate on customs duty on aviation fuel from March 1949.[374] The government also introduced the 'All Up' mail scheme in April 1949 to boost revenue for airlines. Under this scheme, the surcharge which was paid for air mail was abolished and all domestic mail was accordingly transported by air to Delhi, Calcutta, Bombay and Madras, from where they were forwarded to their destination.[375]

2.2. Night Air Services

Another scheme introduced by the independent Indian government to relieve the airlines was the Night Air Mail Service in 1948. The scheme provided for air transportation of mail at night to the major cities (Calcutta, Bombay, Madras and Delhi). The routes prescribed were Delhi-Nagpur-Madras and Bombay-Nagpur-Calcutta. The plan envisaged that aircraft would simultaneously take off from Delhi, Bombay, Madras and Calcutta around midnight and return to the starting points by morning.[376]

This scheme received criticism from airlines for not providing subsidies or assurances of minimum payment and load or higher rates than had previously been in effect. The government was adamant that providing subsidies would be averse to the growth of the industry as it would not incentivise carriers.[377] After several rounds of discussion with the airlines, the scheme was officially launched in 1949. With the launch, carriers generated higher revenues in addition to the revenue coming from day services. The scheme also provided training to pilots to fly at night time and boosted cargo traffic, especially for perishable and emergency goods like medicines and medical equipment. Postal services also grew and became fast, and mail posted from one of the four major cities reached its destination by the next day.[378]

2.3. International Operations

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[372] *Enquiry Committee*, *supra* note 335 at 14.
[373] Menon, *supra* note 316 at 40.
[374] *Ibid.*
[375] *Ibid.*
[376] *Ibid* at 38.
[377] *Ibid* at 39.
[378] Gidwani, *supra* note 322 at 100.

Prior to independence, India did not have any independent carriers engaged on international routes. Foreign airlines served the country and by 1947 airlines like Pan Am, TWA, KLM and Air France had either established services or were in the process of starting to fly to and through India.[379] The government realised that once the foreign airlines solidified their presence on the lucrative international routes, it would be difficult for an Indian carrier to enter the field. The government was confident that it was time for India to have its own carrier engaged in external services without the support of any foreign agency.[380] The government entered an agreement with Air India (formerly Tata Airlines) to establish a new company, Air India International, in 1949.[381] As per the agreement, the government would hold 49% shares in the new airline company and the remainder would be held by Tata Industries and the public. The board of directors would comprise six members, two of whom would be nominated by Air India, three by the government and one other who would represent the general shareholders. The government also agreed to reimburse Air India International for actual losses reported during the first five years of its operations; however, when the company would become profitable, not less than 50% of the annual profits would be returned to the government as repayment of the subsidies paid in the initial years. Air India International was given the exclusive rights to fly on all routes to the west of India within a specified zone for ten years.[382] Air India International flew its first flight on 08 March 1948 from Bombay to London.[383]

In 1949, Bharat Airways was granted permission by the Air Transport Licensing Board to commence international services to the points east of India. The first route it was authorised to fly was Calcutta-Bangkok-Hongkong-Shanghai-Tokyo.[384] Unlike Air India International, the government did not provide any financial assistance to Bharat Airways in the initial years but later in the 1950s, realising that the airline was running into losses, the government agreed to provide subsidies for the losses on specific routes. Another carrier – Himalayan Airways – was initially established in 1951 to undertake non-scheduled air services and air surveys but it also started external services between Ahmedabad and Kabul in the later years.[385]

However, the international services, as well as the domestic services, were not very profitable, and the carriers extensively relied on government aid. State assistance and new schemes by the

[379] Menon, *supra* note 316 at 35.
[380] *Ibid* at 35.
[381] *Enquiry Committee*, *supra* note 335 at 18.
[382] *Ibid* at 18.
[383] *Ibid* at 19.
[384] Menon, *supra* note 316 at 38.
[385] Gidwani, *supra* note 322 at 101.

government created some relief for airlines but a permanent solution was needed. For this purpose, the government set up the Air Transport Enquiry Committee in February 1950 to study the state of the industry and make recommendations.

2.4. The Enquiry Committee

The Air Transport Enquiry Committee was officially appointed by the Ministry of Communications, Government of India on 08 February 1950 and was headed by a distinguished High Court Judge, Justice Rajadhyaksha. The government noted that 'there has been rapid expansion of civil air transport service in India…with some concerns that the air transport industry has not found sustainable'[386] The purpose of the committee was to review the current state of air transport and advise the government on future developments to ensure 'operation of air services is placed in a firm economic footing and that the future development of air transport proceeds on sound and healthy line.'[387]

The committee submitted its report in September 1950, which blamed the government for the unsatisfactory condition of the industry in India. Particularly it pointed out that unmindful licensing of too many operators had led to wasteful competition, excess capacity, increased costs and lower revenue.[388] The committee stated that the number of operators was higher than the demand for air transport. Due to intense competition among carriers, fares were reduced to levels that were not economically sustainable. As a result, the rate of earnings decreased in comparison to costs.[389] As a result of higher supply compared to demand, carriers also faced a problem of over-equipment.[390] Along with over-competition, the committee noted that most of the remunerative routes were allocated to one airline – Air India - and other airlines were left with less remunerative routes. Furthermore, due to the availability of limited technical personnel, there was a higher demand for them which resulted in higher wages thereby increasing the operating costs of airlines. State sale taxes along with customs duty on aviation fuel also added to the operating costs of carriers.[391] The report also blamed some carriers for the current situation, especially their lack of proper planning and building up large organisations with little regard to the actual magnitude of their operations.[392]

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[386] *Enquiry Committee*, *supra* note 335 at 1.
[387] *Ibid.*
[388] *Ibid* at 52.
[389] *Ibid* at 58.
[390] *Ibid* at 54-55.
[391] *Ibid* at 57-58.
[392] *Ibid* at 56.

The committee reiterated Sir Frederick's recommendations that the ideal number of airlines operating in India should be limited to four with their bases at Bombay, Delhi, Calcutta and Hyderabad.[393] The committee proposed mergers of some airlines to increase efficiency and reduce competition which would lower operating costs.[394] It also proposed the redistribution of assigned routes among the existing airlines to increase efficiency and coverage.[395] The committee also proposed fixing fares at a certain rate depending on the miles flown to allow airlines to generate adequate revenue (at least 10% return on investment to operators). Importantly the committee recommended government subsidies under which airlines meeting the target would generate profits.[396] A detailed discussion on nationalisation with the pros and cons was done in the report but the committee suggested against nationalisation and recommended maintenance of the status quo.[397] It noted:[398]

> [The] operating companies are already in the field, and unless there were imperative necessity, there would appear to be no compulsion to take such a serious step as nationalization at present.

Notwithstanding the recommendation of the committee, the government nationalised the aviation industry in 1953.

3. Nationalisation

3.1. Motivation for Nationalisation

Post-independence the government declared a new industrial policy in 1948 which laid down the government's intent to develop industries in India with particular reference to nationalisation. The policy stated:[399]

> The State could contribute more quickly to the increase of national wealth by expanding its present activities.

With respect to nationalisation, the government stated that the State has the inherent right to acquire, in the public interest, any existing industrial undertaking. The policy categorised industries into four categories and transportation was placed in category one which was to be

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[393] *Ibid* at 110.
[394] *Ibid.*
[395] *Ibid* at 216.
[396] *Ibid* at 140.
[397] *Ibid* at 217.
[398] *Ibid.*
[399] India, Government of India, *Statement on Industrial Policy of Indian Government, 6 April, 1948* (Selected Documents on Asian Affairs - 1947-60, 1959) at 568.

the exclusive monopoly of the government.[400] The adoption of the Constitution in 1950 which declared India as a welfare State further sparked interest in nationalisation among the policymakers.[401] Particularly the Directive Principles of State Policy laid down in Article 39 states that:

> The State shall, in particular, direct its policy towards securing….(b) the ownership and control of the material resources of the community are so distributed as best to subserve the common good; and (c) the operation of the economic systems does not result in the concentration of wealth and means of production to the common detriment…..

These general principles on State interference in industrialisation were given effect with the adoption of the Industrial (Development and Regulations) Act, 1951.[402] This essentially meant that industries that were of strategic importance would be public sector.[403]

With respect to the aviation industry in India, even though the Enquiry committee had recommended against nationalisation, contrary to all expectations, the situation of Indian aviation started getting worse from 1951 onwards. By the end of 1952, the performance of most Indian airlines had deteriorated due to multiple reasons, the most important of those being the rise in the price of aviation turbine fuel and wages and salaries of staff. Overcapacity coupled with lower demand further added to the problem.[404] With no new capital, the costs of operations increased, and airlines ran into financial problems.[405] The government had to decide between nationalisation or extensive subsidies to revive the industry. The risk of providing subsidies which would lead to an increase in wasteful competition without meaningful development at the cost of public money could not be ignored. The government was unwilling to bear the cost and given the policy trend in India towards the nationalisation of industries, the government decided to nationalise the aviation industry.[406]

Apart from this economic reasoning, nationalisation in India was grounded in the public utility doctrine.[407] While introducing the bill to nationalise the airline industry, the government justified its actions by claiming that:[408]

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[400] B M Josiam, R K Zutshi & Z U Ahmed, "India's Economic Reforms: Interpreting the Dynamics of Change from a Contextual Perspective" (1999) 9:1 Competitiveness Rev 68 at 69.
[401] *The Indian Constitution*, 1950 (India).
[402] *The Industrial (Development and Regulations) Act 1951,* Act 65 of 1951 (India).
[403] *Ibid,* s 2 read with schedule 1.
[404] Menon, *supra* note 316 at 45-46.
[405] Hooper, "Deregulation: Australia and India", *supra* note 40 at 107.
[406] India, Lok Sabha, *House of People Debates* (20 April 1953) at column 4632-4633.
[407] See chapter 1, para 1, *above.*
[408] *House of People Debates*, *supra* note 406 at column 4635.

> Air transport was a public utility service and ought to be developed in the national interest, unhampered by the paramount necessity of making a profit which would be the over-riding consideration in private enterprise...[State] organization would also be able to plan the future of the industry in a more comprehensive way

Noteworthily, this was the same reasoning used by the US to regulate its aviation industry in 1938.[409] Both the US in the 1930s and India in the 1950s believed that only the State could develop a socially desirable aviation network in the country with reasonable price and proper connectivity and such a network is crucial for the development of the countries. Civil aviation being a public utility must be controlled by the government. However, the difference between the Indian approach and the US approach to establishing government control was that, while in the US the regulatory agency (CAB) was granted wide powers to regulate the functioning of privately owned carriers,[410] in India, the carriers were owned and operated by the government. Therefore, India had stronger governmental control over the industry compared to the US even during the era of regulations. For practical purposes, the difference between these two approaches was that in the US, even within the four walls of regulations, the carriers being private entities competed and were motivated to make profits. Since they did not have government backing, if the entities failed to generate profits, they would go bankrupt. On the other hand, in India, the government carriers enjoyed a duopoly and lacked the motivation to incur profits. They heavily relied on the federal treasury.

3.2. The Air Corporations Act of 1953

The Air Corporation Act 1953 - the act to nationalise the industry - was adopted in 1953 and stayed in force till 1994.[411] The act established two corporations – Air India International (for international air services) and Indian Airlines (for domestic air services) [412] – with the function to provide 'safe, efficient, adequate, economical and properly co-ordinated air transport services' both domestically and internationally.[413] The Act granted duopoly to the two corporations to carry out civil aviation in and outside India[414] and operating scheduled air transport in contravention of the act was an offence punishable by a fine or imprisonment.[415] Consequently, the corporations took over all the nine existing carriers along with their assets

[409] See chapter 1, para 1, *above.*
[410] *Ibid.*
[411] *The Air Corporations Act 1953*, Act XXVII of 1953 (India) [repealed].
[412] *Ibid,* s 3(1).
[413] *Ibid,* s 7(1).
[414] *Ibid,* s 18(1).
[415] *Ibid,* s 18(2).

and liabilities.[416] The corporations would not only ensure the best development of air transport but also secure that services were provided at reasonable charges.[417]

Section 7 of the Act endowed the corporations with powers to operate air transport services and carry out all forms of aerial work for commercial and other purposes. It had the power to determine and levy fares and freight rates with prior approval of the central government.[418] The corporations could acquire, hold or dispose of property or any other air transport entity.[419] The corporations could also enter into a contract with other persons engaged in air transport to provide services on their behalf or in association with them[420] along with promoting any organisation outside India for engaging in any activity which the corporations have the power to carry on.[421] Apart from flying rights, both the corporations were also granted the power to provide training and instruction,[422] and carry out repair, overhaul, reconstruct, assemble, or recondition aircraft and their component parts.[423] Lastly, each of the corporations had the power to take steps to promote air transport and related services within and outside India.[424]

Along with the corporations, the act also granted certain powers to the central government to regulate the corporations – Air India and Indian Airlines. Section 34(1) gave powers to the government to give directions to the corporations and the corporations would be bound by such directions. These directions could include an order to undertake new air transport services or discontinue or change scheduled air services or conduct any other activities which the corporations had the power to undertake. The central government also had powers to grant approvals vis-à-vis finance.[425] The central government had the power to provide capital to the corporations for the conduct of its business or any other related purposes.[426] Consent of the central government was also required to borrow money.[427] No capital expenditure could be undertaken to purchase or acquire immovable property or aircraft without prior approval of the central government.[428] Any lease agreements entered by the corporation for a period exceeding ten years required government approval.[429] Furthermore, disposal of properties or rights and

[416] *Ibid,* s 6(a).
[417] *Ibid,* s 7(1).
[418] *Ibid,* s 7(2)(i).
[419] *Ibid,* s 7(2)(d).
[420] *Ibid,* s 7(2)(h).
[421] *Ibid,* s 7(2)(c).
[422] *Ibid,* s 7(2)(b).
[423] *Ibid,* s 7(2)(e).
[424] *Ibid,* s 7(2) (j-k).
[425] *Ibid,* s 35.
[426] *Ibid,* s 10(1), (2).
[427] *Ibid,* s 10(3).
[428] *Ibid,* s 35(a).
[429] *Ibid,* s 35(b).

privileges exceeding a certain value (as determined by the central government from time to time) would also require prior approval.[430]

The government exercised complete control over the corporations with respect to the management of business affairs. Each corporation was required to submit a statement prior to the beginning of each financial year 'showing the programme of operation and development of air transport services to be operated by the corporation and its associates during the forthcoming financial year and its other activities as well as its financial estimate in respect thereof, including any proposed investment of capital and increase in the strength of its total staff'.[431] At the end of each financial year, the corporations were required to give a report of their activities during the previous financial year.[432] The day-to-day management of the corporations was vested in a board of directors which was appointed by the government including the chairman.[433] The corporations had the authority to hire a managing director and other officers and employees, but the appointments were subject to rules prescribed on this behalf and also subject to the approval of the central government.[434]

The government assumed all powers to not only regulate but also operate civil aviation in India. The two corporations – Air India and Indian Airlines – were wholly owned by the government and it controlled both the management and expenditures of the carriers. The private sector was shut out both domestically and internationally.

3.3. Indian Airlines during Nationalisation

This section pertains to a discussion of the overall performance of Indian Airlines post-nationalisation. The corporation, established in 1953 by the absorption of eight different domestic airlines, was in turmoil in the initial years.[435] The corporation had inherited the chaotic route structures and operational patterns of the existing airlines which were operating at losses. The defective organisational structure including the size of staff and over equipment given the capacity at that time added to the problem.[436] However, with the growth of the agricultural sector and industrialisation as a result of the adoption of three successive five years plans, the overcapacity problem was soon reversed and the demand for air travel exceeded

[430] *Ibid,* s 35(c).
[431] *Ibid,* s 36(1).
[432] *Ibid,* s 37(1).
[433] *Ibid,* s 4(1A).
[434] *Ibid,* s 8(1).
[435] The eight air1ines were Air India, Air Services of India, Airways India, Bharat Airways, Deccan Airways, Himalayan Aviation, Indian National Airways and Kalinga Airlines.
[436] India, Air Transport Counci1, *Report on Indian Air1ines Corporation's Fares and Freight Rates* (1957) at 23.

Indian Airlines' capacity. The prime reason for this was the low flying capacity of the fleet it had acquired coupled with its deterioration in efficiency. All these factors along with the increasing costs of maintenance and spare parts resulted in financial losses in the initial five years of its operations.[437]

The government realised this problem and in the first five years plan committed to State assistance in renewing the fleet.[438] Even then, Indian Airlines incurred losses in its initial years and only crossed the break-even point in 1959-60.[439] The airline made steady but gradual profits between the years 1960-64. However, between the years 1965-74, the airlines again incurred losses to the tune of USD 2.63 million. Thereafter, from 1975 onwards until 1990 Indian Airlines remained extremely profitable. Chart 2.1 demonstrates the profit and loss incurred by Indian Airlines during the peak of nationalisation (1960 -1994).

Chart 2.1: Five Years Average Profit/Loss of Indian Airlines (1960-94)

Year	Profit/Loss (Million USD)
1960-64	1.342
1965-69	-0.045
1970-74	-2.585
1975-79	9.206
1980-84	24.632
1985-89	20.703
1990-94	-121.44

Source: ICAO, Financial Data: Commercial Air Carriers

As is evident from the chart, Indian Airlines remained extremely profitable for more than fifteen years during the peak era of nationalisation. However, it is important to note that a major reason for such high profits was the monopoly given to Indian Airlines in the Indian market. The same reason explains the decline in profits post 1992. In a period of four years, between 1990—1994, the reported losses of Indian Airlines amounted to USD 121.44 million. The government, even though had monopolised the industry, allowed private air taxi operators to operate non-scheduled air transport services from 1986.[440] The traffic of non-scheduled air services increased from 41,916 in 1991 to 725,812 in 1992, an increase of almost 1632%, thereby giving tough competition to Indian Airlines.[441] While traffic for these private operators increased, Indian Airlines witnessed a loss of traffic of almost 14.5% in the same period.[442] Even the Lok Sabha (the lower house of the Indian Parliament) Committee on Public Undertaking 1993-94 noted that Indian Airlines reported losses of almost USD 90 million for a period of nine months till

[437] ICAO, *Civil Aviation Statistics of the World (1954-1991).*
[438] *1st Five Year Plan*, *supra* note 362 at 175.
[439] *Civil Aviation Statistics of the World, supra* note 437.
[440] Hooper, "Deregulation: Australia and India", *supra* note 40 at 109.
[441] S Bhatt, *The New Aviation Policy of India: Liberalization and Deregulation* (Lancers Books, 1997) at 194.
[442] *Ibid.*

December 1993 due to the substantial increase of non-scheduled services by air taxi operators.[443] However, this was not the only reason why Indian Airlines was reporting losses. On one hand, it suffered overcapacity on certain routes, especially on those served by air taxi operators, and on the other hand, it also suffered from a lack of adequate fleet. In the later years, the government was reluctant to invest in replenishing Indian Airlines' fleet.[444] Overcapacity and poor condition of the fleet led to deteriorated and limited services and the airline constantly kept losing market share and profits.

3.4. Air India during Nationalisation

During the period of nationalisation between 1960 to 1990, Air India International was a fairly profitable enterprise. The below table summarises Air India's profits.

Chart 2.2: Five Years Average Profit/Loss of Air India International (1960-89)

Year	Profit/Loss (Million USD)
1960-64	3.671
1965-69	3.321
1970-74	-2.137
1975-79	16.637
1980-84	23.432
1985-89	23.269

Source: ICAO, Financial Data: Commercial Air Carriers

The financial performance of Air India is *prima facie* quite remarkable. It stands out for two reasons. *Firstly,* unlike Indian Airlines, Air India did not enjoy a monopoly, rather it competed with the world's best airlines. *Secondly,* Air India through its performance generated revenue for the purchase of aircraft (through foreign loans) than depending on the government.[445] However, the profitability of the carrier does not portray a complete picture of its performance. According to the 'Committee on Public Undertakings (1986-87) Report', only one of the sixteen routes travelled by Air India was profitable.[446] It was the route to the Middle East, including Bahrain, Kuwait, Qatar, Saudi Arabia, Oman, and the United Arab Emirates. The reason for such high profits was largely because of the frequent travel by migrant workers.[447] The report rightly noted:[448]

[443] See India, Committee on Public Undertakings, *Thirty-Third Report: Indian Airlines: Under-Utilization of Fleet, Idle Wages to Flying Crew, Avoidable Payment on Leased Aircraft, Wasteful Expenditure on Training Of Pilots, and Delay in Commissioning of Jet Engine Shop* (New Delhi: Lok Sabha Secretariat, 1994).
[444] See India, Committee on Public Undertakings, *Fifty-first Report: Air India-Fare Aspect* (New Delhi: Lok Sabha Secretariat, 1989).
[445] Nayar, *supra* note 28 at 6-7.
[446] India, Lok Sabha Committee on Public Undertakings, *Fourteenth Report: Air India – Working Results and Traffic Growth* (New Delhi: Lok Sabha Secretariat, 1987) [*Lok Sabha, Fourteenth Report*].
[447] Nayar, *supra* note 28 at 11.
[448] *Lok Sabha, Fourteenth Report, supra* note 446 at 16 & 27.

> [the] India-Gulf route has been the revenue spinner for Air India…[B]ut for the India-Gulf route Air India would have been incurring heavy losses every year.

Irrespective of being the only Indian carrier flying international routes, Air India performed poorly in comparison with its foreign counterparts on all other routes except the Gulf route. One important aspect of international aviation is the bilateral exchange of traffic rights between States which is based on reciprocity. Traditional bilateral ASAs gave carriers of each State the right to 50% of the international traffic between the States. Even then Air India's share in traffic declined. By 1990, foreign carriers' traffic share to and from India increased to 70% from 50% in 1971.[449] The following table demonstrates the declining India's international traffic share (passengers to and from India) of Indian carriers:

Chart 2.3: Five Years Average Share of Indian Carriers in India's International Traffic (1970-95)

Year	Total India's International Traffic (Thousand)	Traffic Carried by Indian Carriers (Thousand)	Percentage Traffic Carried by Indian Carriers
1970-74	1266	604.75	47.77
1975-79	2341.4	1158.8	49.49
1980-84	4554.6	1957.8	42.99
1985-89	6392.8	2200	34.41
1990-95	7532	2212	29.44
Source: ICAO Civil Aviation Statistics of the World			

Particularly, in the Asia Pacific market, Air India's share had dropped from 10.5% in 1961 to less than 5% by the 1990s.[450] The 'Committee on Public Undertakings (1978-79) Forty-Eighth Report' stated that despite Indian carriers' right to 50% of international traffic, foreign carriers were operating a higher number of flights compared to India. The reason for this poor performance despite the reservation arising from bilateral agreements was poor capacity. The 'Committee on Public Undertakings (1988-89) Fifty-First Report' claimed:[451]

> The reason is lack of growth [of] capacity. Whereas we have remained stagnant in the last ten years, other airlines have grown tremendously.

The government's policy of putting restrictions on fleet expansion due to financial constraints of the government caused a severe capacity problem which adversely impacted the growth of Air India. Furthermore,

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[449] Nayar, *supra* note 28 at 19.
[450] Arijit Mazumdar, *Deregulation of the Airline Industry in India: An Analysis of the Government's Policy, Rationale and Strategy* [PhD Thesis, Miami University, 2008) at 34.
[451] See India, Committee on Public Undertakings, *Fifty-first Report: Air India-Fare Aspect* (New Delhi: Lok Sabha Secretariat, 1989).

> State ownership and associated lack of managerial autonomy led to extra-market (political) priorities in investment decisions. This affected Air India's ability to renew and expand its fleet.[452]

Therefore, the policy regime and regulations were blamed for the poor performance of both Air India and Indian Airlines.

4. Deregulation and Rationale for Deregulation

4.1. Rationale for Deregulation

The winds of deregulation started to howl during the mid-1980s. While the poor performance of the government-owned carriers along with the rise in demand and popularity of air taxi operators were important factors, there were other domestic and international factors that led to deregulation.

4.1.1. Economic Development in the Country

As mentioned earlier, post-independence there was a strong nationalist motivation among the policymakers and the government had established several public sector enterprises across various sectors including aviation. However, India witnessed slower economic growth compared to other developing countries in Asia-Pacific.[453] India faced a severe balance of payment crisis in 1991.[454] To counter the problems, in 1991, the then Prime Minister P.V. Narasimha Rao took the bold step to open up the economy. Since then, India has been progressively liberalising the economy by abolishing government controls, regulations and licensing mechanisms.[455] Deregulation of the airline industry was part of a larger economic liberalisation agenda adopted by the government. The development of aviation was an important aspect of economic development in the country. Liberalisation of the economy in the mid-1980s triggered an increased demand for air services. The government's policy to promote export to increase India's foreign exchange relied on air transport. Even within the country, good air transport links were essential for industries to develop as it facilitates trade and travel. It stimulated trade and commerce by connecting different parts, especially remote areas. Tourism both international and domestic was another important industry that fostered

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[452] Mazumdar, *supra* note 450 at 38.
[453] Josiam, Zutshi & Ahmed, *supra* note 400 at 74.
[454] Valerie Cerra & Sweta Chaman Saxena, "What Caused the 1991 Currency Crisis in India?" (2000) IMF Working Paper No. WP/00/157 at 1.
[455] Josiam, Zutshi & Ahmed, *supra* note 400 at 75.

economic growth in the country which heavily relied on air transportation. Increasing the foreign tourist arrival in India would address the balance of payment issue India was facing.

Even though the development of air connectivity was essential for the economy, the government was financially constrained to expand the fleet of government-owned carriers, which was required for the larger economic development. The government-owned carriers were performing badly. It felt that deregulation could encourage private investment and participation and address the capital and capacity shortage. It would lead to the entry of private commercial operators which would help India develop a proper air transport network with increased flight frequency and capacity.[456] Competition among private entities was also considered essential. The then Minister for Civil Aviation Madhavrao Scindia claimed that 'an element of competition in the provision of domestic air services is desirable… [and this] will lead to improvement in efficiency of air services.'[457]

The government also encouraged liberalisation in international air services. With respect to international air connectivity, the government was of the opinion that liberal exchange of traffic rights would encourage foreign airlines to expand operations in India which would bring in much required foreign investment to the country.[458] Since Air India had capacity constraints, it influenced the government to allow foreign carriers to fill the gap which would ultimately aid in India's larger economic liberalisation. Therefore, the impact of civil aviation on economic development motivated the government to deregulate the industry as it would bring in the capital and capacity essential for improving air connectivity.

4.1.2. Increase in Demand for Air Services

The economic development in the country had increased the demand for air services and the national carriers were unable to cater to this increased demand.[459] Poor conditions of fleet and services, lack of capital, failure to incur profits and the reluctance of the government to invest in Air India and Indian Airlines had led to reduced air connectivity. But the country was experiencing a growth in both domestic and international passengers at a compound annual growth rate of 8.8% and 5.76% respectively between 1996 and 2006.[460]

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[456] K Raguraman, "Troubled Passage to India" (1998) 19:6 Tourism Management 533 at 540-41 [Raguraman, "Troubled Passage"].
[457] See Interview of Madhavrao Scindia, "Airlines are not my Babies" (June 30, 1992) on *The Economic Times*.
[458] Mazumdar, *supra* note 450 at 41.
[459] *1st Five Year Plan*, *supra* note 362 at chapter 31, introduction.
[460] Mazumdar, *supra* note 450 at 45.

To cater to this growing demand, the government had no choice but to deregulate to allow entry of private players. Air India was continuously losing market share and was unable to bring in the required foreign exchange, and Indian Airlines was incurring losses and unable to fulfil the growing demand. Non-scheduled air taxi operators were filling the gap.

On the one hand, the government was financially constrained to invest in fleet augmentation, but on the other hand, the national carriers survived due to government protection. The issue was whether the government wanted its carriers to merely survive or see the airlines become efficient and competitive. While protection may ensure survival, the government felt private participation and liberalisation would increase competition which would stimulate Indian Airlines and Air India to increase their efficiency and perform better.[461]

Furthermore, the poor performance of the national airlines forced the government to re-evaluate the regulatory policies of nationalisation. State ownership might have reduced their operational efficiencies as the government subsidised their operations. Even the 'Planning Commission Report of 1989' noted:[462]

> Fifty years of experience in public ownership and government regulation of entry, fares and freights and capacity…cast doubts on the validity of some of the arguments advanced for regulation/public ownership.

Growing demand and poor performance of the national carriers were other major motivating factors for the government to deregulate the industry.

4.1.3. International Trend

As mentioned in chapter one, air transport deregulation, though started in the US in the late 1970s, triggered a global trend and a chain of reforms in civil aviation throughout the world. Within the next decade, States like New Zealand, Australia, Canada, and the U.K. went ahead with liberalisation.[463] While the extent of deregulation differed from State to State, the common elements of deregulation were free entry and exit of carriers into the industry, freedom to select routes and set fares and removal of subsidies.[464] By the 1990s, the pace of deregulation accelerated and developing countries like Mongolia, Papua New Guinea, and China embraced deregulation. The motivating factors were the increase in efficiency and impressive profits of

[461] Raguraman, "Troubled Passage", *supra* note 456 at 541.
[462] See India, Planning Commission, *Air Traffic Committee Report* ((New Delhi: Lok Sabha Secretariat, 1989).
[463] Hooper, Hutcheson & Nyathi, *supra* note 2 at 396.
[464] *Ibid* at 396.

carriers in the countries that undertook deregulation. Competition had a positive impact on the performance and the industry consolidated with time and emerged efficient. The success and the trend of deregulation in other States prompted India to respond in a similar way which eventually led to deregulation.

4.2. Comparison with the US

Recalling the discussion in chapter one, the US did not have a nationalised carrier like India, rather the operations of all private airlines had been strictly regulated prior to deregulation.[465] The legitimacy of the market failure argument to support regulations came under strong theoretical and empirical attacks by economics and academicians. Regulations were seen to favour airlines rather than consumers and they promoted inefficiency as they did not incentivise competition among airlines. There was evidence that deregulation had the potential to bring down fares and costs would also reduce if liberal market arrangements were permitted.[466] Extensive research and public debate preceded prior to deregulation and was followed by a period of active monitoring. However, this was not the case with most developing countries, including India.

Despite the lack of detailed information and research about the industry, India had no option but to be quick to deregulate to cope with the rapid growth. Prof. Paul Hooper rightly said:

> Despite a well-developed literature on airline deregulation and competition [from developed countries], there is a dearth of analysis that translates this knowledge for the benefit of policy makers and airlines in the developing countries.[467]

While in the US, the motivation to deregulate was based on research that suggested it would make the industry more efficient, the motivation for India was simply to overcome resource constraints as the government was financially incapable of investing the level of resources necessary to increase capacity adequately. The purpose of allowing private players was to expand the capacity to cope with the increasing demand. Liberalisation in India happened primarily due to the pressure of traffic growth which the government carriers were unable to cater to. Therefore, unlike in the US, where liberalisation was born out of a desire to reform the industry, in India liberalisation of the air transport industry was to assist in the growth of the market and the economy at large.

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[465] See chapter 1, para 2, *above.*
[466] Hooper, Hutcheson & Nyathi, *supra* note 2 at 396.
[467] Hooper, "Deregulation: Australia and India", *supra* note 40 at 105.

While the benefits of liberalisation in India were apparent, there were substantial challenges involved for India compared to the US. Most significant was the importance of air transportation for the national development and the pursuit of social equity goals. Airlines provide essential services to all parts of the country, especially remote parts, which act as a catalyst for economic growth. There always remains a possibility that new entrant carriers would fail, but at the same time, the government could not afford to lose connectivity to remote parts of the country merely because some airlines went bankrupt. Even in the liberalised regime, the government needed to ensure connectivity to all parts of the country. While even the US had to ensure air connectivity to remote areas, the unique challenge for India was that the transport system needed to cater to 1.1 billion people and ensure good connectivity essential for economic growth.[468] Surface transport in India was poor. Roads, which carried almost 85% of the country's traffic, were narrow and congested. Even though India has one of the largest railway networks, it suffered from major capacity constraints.[469] Therefore, the priority for India to ensure air connectivity was not hampered by liberalisation was much higher.

Moreover, resources including capital for the development of an advanced aviation network were constrained, which was never the problem in the US.[470] Aviation infrastructure and services were at an early stage of development. The government in India also had to manage its dual expectations that the national carriers would perform profitably in a liberalised market as well as support the government's policies and social objectives.[471] This often ended up with the government carriers getting privileges and subsidies and therefore there was no level-playing field between the private carriers and the government carriers. This protectionist approach often hindered the development and implementation of effective policies to liberalise the market.

These factors had an impact on India's air transport liberalisation journey. Because of these inherent risks, the extent, pace, and approach toward air transport deregulation in India were different from the US approach. The following chapter focuses on the deregulation experience of India from the start to date with a comparative analysis with the US.

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468 "India Transportation" (23 September 2011) online: *World Bank* <https://www.worldbank.org/en/news/feature/2011/09/23/india-transportation>
469 *Ibid.*
470 Hooper, Hutcheson & Nyathi, *supra* note 2 at 402-03.
471 *Ibid* at 397.

CHAPTER 3 – CRITICAL AND COMPARATIVE ANALYSIS OF INDIA'S LAWS AND REGULATIONS

1. Early Days of Deregulation in India (1994 - 2003)

The government of India took the first concrete step towards deregulation in 1986 when the Minister of Tourism and Civil Aviation approved the air taxi scheme with fifteen operators granted licences.[472] This step was taken in accordance with the recommendation of the Planning Group of 1986 on 'Civil Aviation at the Turn of the Century' which suggested allowing air taxi operators to promote tourism.[473] However, these air taxi operators were still subject to several restrictions regarding aircraft capacity, flight routes, airports, flight schedules, importing aircraft, foreign exchange, and ownership.[474] Due to these restrictions, the capacity constraints of the aviation industry were unsolved and criticism about strict economic regulations continued to mount.[475]

The 'Planning Commission Report on Tourism, 1988' argued that the government must bring in liberal aviation policies as the national carriers were unable to meet the requirements of capacity and promote tourism in the country.[476] Accordingly, the government constituted the 'Committee on Transport and Tourism of the Rajya Sabha (Upper House of the National Assembly)' in 1993 which in its report recommended repealing the Air Corporations Act 1953, and bringing an end to the government monopoly over scheduled services.[477] The Committee acknowledged that while the government had allowed private participation in the airline industry, there was a need to remove regulatory restrictions, especially in domestic scheduled services.[478] The committee noted that there were several hindrances faced by the private taxi operators *viz* absence of clear policies, restrictions on publishing and advertising schedules, restrictions on cargo operations, lack of airport facilities, unclear policy on the import of aircraft etc. and suggested that the government bring clear policies to this end and remove the restrictions imposed on the private operators.[479]

Accordingly, in the early 1990s, the government implemented an 'open skies' policy whereby several restrictions were eased, and private taxi operators could decide their flight schedules

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[472] K Mhatre, "Private Carriers Unbridled" (1994) 31:4 Air Transport World 99 at 100.
[473] India, Planning Commission of Government of India*, Report of the Planning Group on Civil Aviation at the Turn of the Century* (New Delhi, 1986) at 20.
[474] Mazumdar, *supra* note 450 at 50.
[475] *Ibid.*
[476] India, Planning Commission Government of India, *Report of the National Committee on Tourism* (New Delhi, 1988).
[477] India, Rajya Sabha Parliament of India, *Second Report on Government Policy on Private Air Taxi Operation and Matters Connected Therewith* (New Delhi: Committee of Transport and Tourism, 1993) at para 5.3.
[478] *Ibid* at para 5.8.
[479] *Ibid.*

and airfares.[480] The government also tabled the Air Corporations (Transfer of Undertakings and Repeal) Bill, 1992 to end the monopoly given to the national carriers. The removal of restrictions and the unfortunate fatal crash of Indian Airlines A320 aircraft in 1990 which led to the grounding of a majority of its fleet following investigation[481] created the best opportunity for the private sector to grow and, taking this advantage, East-West Airlines commenced operations from February 1992.[482]

The time was ripe as the incumbent government-owned airline suffered from inadequate capacity and a prolonged pilots' strike at Indian Airlines made it worse.[483] This marked a beginning of a new era and following East-West Airlines, other carriers like Jet Airways, Damania Airways, ModiLuft and NPEC commenced operations as air taxis.[484] They took advantage of the government's policy to allow foreign investment of up to 40% of their equity from foreign sources.[485] Jet Airways secured 20% funding each from Kuwait Airways and Gulf Air and used it to build a fleet comprising four Boeing 737-300 aircraft.[486] Similarly, ModiLuft was backed by German carrier Lufthansa. By 1993, seventeen operators had already been granted licences to operate air taxi services and another twenty were at the preliminary approval stage.[487] This in turn led to not only Indian Airlines losing traffic but also staff defecting to the newcomers.[488] The government, worried about its carrier, responded by putting an embargo on recruiting pilots and engineers from Indian Airlines. The new entrants were also required to fly a certain number of fixed routes above and below 700 km.[489] Indian Airlines stopped contracting out surplus engineers to the private sector. The regulatory environment created impediments for the private sector to grow.

The new entrants saw light when the 'Rajya Sabha Committee on Transport And Tourism' in its Fourth Report emphasised the need to pass the 1992 Bill.[490] In a big boost to the private

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[480] "Organization Setup" online: *Ministry of Civil Aviation* <https://www.civilaviation.gov.in/en/aboutus/orgsetup>
[481] Sanjoy Hazarika, "India Grounds Airbus Planes after Crash", *The New York Times* (10 February 1990), online: <https://www.nytimes.com/1990/02/19/business/india-grounds-airbus-planes-after-crash.html>
[482] Arturo Weiss, "Lost To History, The Indian Airlines that Time Forgot" (30 August 2022), online: *Simple Flying* <https://simpleflying.com/indian-airlines-lost-to-history/>
[483] Hooper, "Liberalization in India", *supra* note 30 at 116.
[484] John F O'Connell & George Williams, "Transformation of India's Domestic Airlines: A Case Study of Indian Airlines, Jet Airways, Air Sahara and Air Deccan" (2006) 12:6 J Air Transport Management 358 at 361.
[485] Jae Woon Lee & Umakanth Varottil, "Against Aviation Orthodoxy: India's Foreign Investment Regime for the Airline Industry" (2018) 44:1 Brook J Intl L 51 at 71.
[486] John F O'Connell & Williams, *supra* note 484 at 365.
[487] Harish Malik & Pravir Malik, "Indian Liberalisation - How to Avoid Repeating the Mistakes of the Past" (1996) 13:5 Avmark Aviation Economist 13 at 17.
[488] Hooper, "Liberalization in India", *supra* note 30 at 116.
[489] Mhatre, *supra* note 472 at 100.
[490] India, Rajya Sabha Parliament of India*, Fourth Report on Air Corporations (Transfer of Undertakings and Repeal) Bill, 1992* (New Delhi: Committee of Transport and Tourism, 1993) at 1-3.

sector and in furtherance of the open skies policy, the government accepted the recommendations of the Rajya Sabha Committee and repealed the Air Corporations Act of 1953 and replaced it with the Air Corporations (Transfer of Undertakings and Repeal) Act in 1994.[491] According to the new act, Air India and Indian Airlines became public limited companies[492] and the 1953 Act was repealed.[493] This ended the forty-year-long monopoly granted to the government-owned airlines in scheduled air services. However, the two corporations remained wholly owned by the government. The new act also removed most of the restrictions imposed on the private sector, but even after deregulation, unlike in the US, Indian carriers were subject to certain restrictions on entry, routes, capacity, fares, foreign investment etc.

1.1. Comparison of the Regulatory Regimes during Deregulation

The 1994 Act did liberalise the industry and allowed private carriers to start scheduled operations, but it did not completely deregulate it as in the US. It becomes crucial to appreciate the underlying reason for this approach. As mentioned earlier, in most developed countries like the US, emphasis was placed on consumer benefits which became the driving factor for deregulation. Extensive academic studies focusing on consumer benefits of deregulation like more and better services and reduced fares were conducted which eventually led to deregulation in the US in 1978. These studies emphasised the importance of free competition which would increase the efficiency of carriers and give passengers more rational choices.[494] The father of air transport deregulation in the US – Prof Alfred Kahn - believed that the constant threat of entry of a new player would prevent an incumbent player from adopting exploitative behaviours and this threat of potential or actual competition would work in favour of consumers.[495] Whereas in developing countries like India, the motive for liberalisation was to assist in the national development and promote the socio-economic upliftment of the country. As discussed in the previous chapter, the intention behind allowing the private sector was to cope with the growing demand for air travel as the government-owned airlines were unable to keep pace. In the US, the intention behind increasing competition among carriers was to increase efficiency, which would in turn bring benefits to consumers. On the other hand, in India, it was expected that competition would increase efficiency which would allow both

[491] *The Air Corporations (Transfer of Undertakings and Repeal) Act 1994*, Act No. 13 Of 1994 (India).
[492] *Ibid,* s 3.
[493] *Ibid,* s 11.
[494] See chapter 1 para 6.1 & 6.2, *above.*
[495] See chapter 1 para 6.2, *above.*

newcomers and the incumbent carriers to overcome the capacity shortage and meet the increasing demands. Moreover, it was also expected that increased competition and lack of monopoly status would allow Indian Airlines to improve their services and generate profits which it was unable to do during nationalisation. Therefore, the motives for deregulation in India and US were significantly different and therefore even to date, the aviation sector is not devoid of economic regulations simply to aid the cause of national development.

1.2. Regulatory Regime during the Initial Years of Liberalisation

With the repeal of the 1953 Act and the adoption of the 1994 Act, private carriers were now allowed to operate domestic scheduled services. However, their activities were and still are regulated by various instruments which were either adopted or amended in light of the new developments. Some of the noteworthy regulations during the initial years of deregulation included restrictions on entry, connectivity and Foreign Direct Investment (FDI). On entry of carriers, the government required applicants to have a minimum of five aircraft in their fleet either through purchase or lease[496] and a minimum subscribed equity capital of Rs.100 million (Rs. 300 million if the operators have an aircraft with a maximum take-off mass exceeding 40,000 kg).[497] The same rule applied to existing operators, and they were required to comply and raise their authorised and paid-up capital and fleet to the prescribed minimum levels.[498] There were also minimum requirements for flight crew (not less than three sets of crews per aircraft) and aircraft maintenance engineers.[499]

With respect to connectivity, the requirement of operating a mix of routes above and beyond 700 km was replaced by the Route Dispersal Guidelines (RDG) of 1994.[500] The guidelines required scheduled carriers to operate a mix of high and low-density routes which were of strategic importance for the national development. The guidelines (contrary to name) mandated airlines to deploy a certain percentage of their capacity measured in available seat kilometres to low-density routes. The purpose of this regulation was to ensure that air services were extended to all parts of the country even if they might not necessarily be commercially viable.[501] Routes were divided into three categories based on demand and geographic

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[496] India, DGCA, *Civil Aviation Requirement Section 3 - Air Transport Series C Part II - Minimum Requirements for Grant of Permit to Operate Scheduled Passenger Air Transport Services,* F. No. AV 14027/2/02-AT-1 (1994) at para 3.2.3. [superseded] [*CAR Section 3 Series C Part II, 1994*].
[497] *Ibid*.
[498] *Ibid.*
[499] *Ibid.*
[500] India, Ministry of Civil Aviation, *Route Dispersal Guidelines 1994,* No. AV-11012/2/94-A (India) [superseded].
[501] *Ibid.*

remoteness. All scheduled airline operators were required to deploy an additional 61% of the capacity it deployed on Category I routes (the trunk routes) on Category II and III routes (the social, less dense routes).[502]

Foreign investment and involvement though allowed were heavily regulated. FDI was permitted up to 40% provided that there was no direct or indirect equity participation by foreign airlines.[503] Even a foreign entity that had a foreign airline as its shareholder was barred from investing. Foreign institutions investing in an Indian airline could have representation in the board of directors of the airline but only up to one-third of the total members[504] and would require a security clearance.[505]

2. Impact of the Regulatory Changes and Comparison with the US

2.1. Entry and Market Share

The relaxation of policies prior to 1994 had already allowed entry of new carriers as air taxi operators. With the new legislation, six carriers, of which some were already operating as air taxis, got the status of scheduled operators in October 1994.[506] East-West Airlines, Jet Airways, Damania Airways, ModiLuft and Sahara Airlines became the prominent players in the domestic liberalised market.[507] India performed relatively well in terms of the number of new entrants. By 1996, India had seven private airlines offering scheduled services and eighteen air taxi firms. As a result, consumers were offered better connectivity and wider choice. With the increase in capacity, the frequency and reliability of services also improved. They also successfully stole the national carrier's market share.[508]

By 1995-96, the private sector carried a total of almost five million passengers as compared to a mere fifteen thousand in 1990. Passenger share of Indian Airlines reduced from 100% to less than 60% and by 1999 and the passenger shares for private scheduled airlines stood at 41.9%. The overall number of passengers carried by Indian carriers also increased and by the end of

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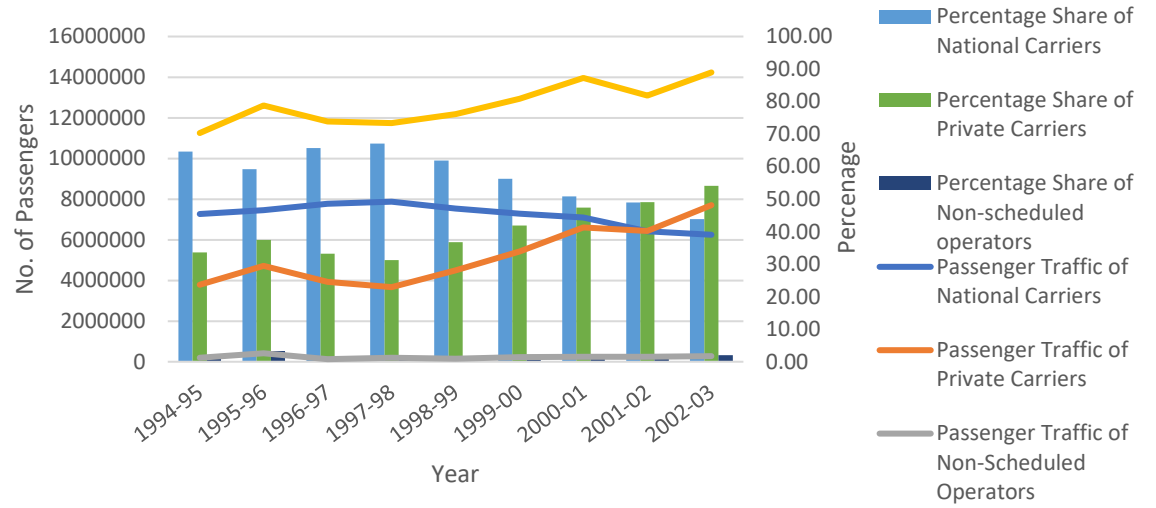
[502] *Ibid.*
[503] Government of India, Ministry of Commerce & Industry, Press Release, No.7(4)/2000-IP "Press Note No. 2 (2000 Series)" (11 February 2000) at 2.
[504] *CAR Section 3 Series C Part II, 1994, supra* note 496 at para 4.1.7.
[505] *Ibid* at para 4.1.13.
[506] See India, DGCA, *Air Transport Statistics for the Year 1997-1998* (New Delhi: 1998).
[507] Rajiv Nagpal & Haritha Saranga, "The Evolution of Indian Civil Aviation" in Matthias Finger & Kenneth Button, eds, *Air Transport Liberalization: A Critical Assessment* (Cheltenham: Edward Elgar, 2017) 92 at 94-95.
[508] Yahua Zhang & Anming Zhang, "Air Transport Development: A Comparative Analysis Of China And India" in Matthias Finger & Kenneth Button, eds, *Air Transport Liberalization: A Critical Assessment* (Cheltenham: Edward Elgar, 2017) 112 at 121.

2000, Indian carriers carried almost fourteen million passengers.[509] Chart 3.1 summarises the passenger traffic and market share of the Indian carriers during this era:

Chart 3.1: Domestic Traffic and Share of National, Private and Non-Scheduled Indian Carriers (1994-03)



Source: DGCA, India

The number of new entrants post-liberalisation in India was comparable to that in the US. The US also saw a drastic increase in the number of new players. These new players in the US gave stiff competition to the incumbent trunk carriers,[510] similar to that in India. The market share of the trunk carriers continued to decrease, and the newcomers carried more passengers. Data shows that the passenger share of the big ten trunk carriers in the US fell by 12% between 1978 and 1983.[511] In India, the passenger share of national carrier fell to 50.8% by the year 2000-01.[512] Noteworthily, since the incumbent US trunk carriers were not performing as badly as Indian Airlines and unlike the Indian national carrier, they gave stiff competition to the newcomers, the decrease in the share of the market of the US incumbents was not as much as Indian Airlines' decline. Indian Airlines went through a massive capacity shortage due to the grounding of A320s, persistent problems with staff including pilots' strikes along with its financial problems.[513]

With the increase in new carriers both in India and the US, flight frequencies had increased and as a result the number of passengers carried by US and Indian carriers also increased. The total number of passengers flying US carriers almost tripled in a period of three decades from

[509] See, chapter 3, chart 3.1, *below.*
[510] See chapter 1, para 6.4.1, *above.*
[511] *Ibid.*
[512] See chapter 3, chart 3.1, *above.*
[513] See chapter 3, para 1, *above.*

approximately 275 million in 1978 to 745 million in 2006.[514] Typically, cities with higher economic and leisure activities saw the highest volume of increase in air traffic in the US.[515] Similarly, India saw a 40% increase in air traffic in five years starting in 1994 when private operators were permitted to operate scheduled services. Most of the increase in traffic was witnessed by the major cities (Mumbai, Delhi, Bangalore, Kolkata, Chennai) with almost two-thirds of India's domestic traffic being handled at these major airports.[516] In essence, air transport deregulation benefitted passengers in both the countries by offering new and more services, increased frequency, and better and more reliable services. Consumers had more choices as a result of deregulation.

2.2. Financial Performance and Market Exits

Even though the problem of capacity was solved to a certain extent, and Indian carriers were ferrying a higher number of people, regulations in the initial years of deregulation posed problems to the Indian carriers. Carriers were not given a free hand and most of the private sector was financially underperforming. Many carriers started running into financial problems. While they saved costs on training by recruiting staff from Indian Airlines, they incurred heavy costs as they ended up paying up to five times the salary of Indian Airlines to attract and retain the staff. A competitive salary was also required to achieve better services by motivating staff.[517]

The RDG added to the misery of the airlines. The guidelines which mandated them to fly to remote parts of the country without subsidies forced the airlines to spread their network across different categories of routes. This deprived the carriers of the opportunity to focus on particularly profitable routes and in turn, they had to operate with low frequency on a large network given the constraints in resources. Airlines had to cross-subsidise unprofitable routes with the profits made on popular routes which affected the overall profitability of the entities.[518] Most airlines usually maintained one type of fleet to ensure reduced costs of operations, but the mandate to fly to non-economical routes using the same class of aircraft resulted in a low utilisation rate.[519] To overcome this problem, East-West Airlines tried maintaining two different types of aircraft – smaller ones for low-density routes and Boeing 737s for regular

[514] See chapter 1, chart 1.2, *above.*
[515] See chapter 1, para 6.4.3, *above.*
[516] Hooper, "Deregulation: Australia and India", *supra* note 40 at 111.
[517] *Ibid* at 113.
[518] India, Ministry of Civil Aviation, *Report of Working Group on Civil Aviation Sector National Transport Development Policy Committee* (New Delhi: June 2012) at para 8.2.2.1 [*Report of Working Group 2012*].
[519] See India, DGCA, *Air Transport Statistics* (New Delhi: Various years between 1997 and 2003).

routes but that proved to be uneconomical as well.[520] The RDG was the major reason for the failure of several airlines.[521]

Other regulatory hardships included the government's change in stance on FDI. When the government allowed air taxi operators, Indian operators were allowed to have equity investment from foreign investors including foreign airlines. However, in later years the government reversed its position on allowing equity injection by foreign airlines.[522] Consequently, in 1997 Kuwait Airways and Gulf Air had to disinvest themselves from Jet Airways.[523] Even Lufthansa had to withdraw from ModiLuft in the same year.[524] This caused a problem of access to capital resources given the capital-intensive nature of the industry. A primary reason behind the failure of ModiLuft was the result of losses following the withdrawal of Lufthansa.[525] Even the proposal by Tata Industries and Singapore Airlines to start a joint venture airline with nineteen aircraft over five years was refused by the Ministry of Civil Aviation due to the recent restriction on investment by foreign airlines. Moreover, even though entry into a liberalised regulatory environment was supposed to be free, the joint venture was refused approval as the ministry was of the opinion that the current domestic aviation was running at overcapacity and there was no need for a new airline.[526]

Heavy taxes and high government fees also added to the financial burden of carriers. The government imposed a 117% surcharge on the price of Aviation Turbine Fuel (ATF) during the Gulf War. The fuel price in India was two-three times the international average. The carriers were forced to charge a 15% Inland Air Travel Tax which increase the airfares. Other fees included high airport charges and customs duty for the import of aircraft.[527] Apart from high taxes, airlines usually worked on the model of leasing aircraft and in that era with Indian Rupees decreasing in value, the cost of leases payable to foreign lessors added to the financial burden.[528]

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[520] Malik & Malik, *supra* note 487 at 15.
[521] Hooper, "Liberalization in India", *supra* note 30 at 122.
[522] See chapter 3, para 1.2, *above.*
[523] Chris Loh, "The Rise and Fall of Jet Airways" (31 July 2020), online: *Simple Flying* <https://simpleflying.com/the-rise-and-fall-of-jet-airways/>
[524] Pranjal Pande, "The History Behind Indian Low-Cost Carrier SpiceJet" (16 August 2021), online: *Simple Flying* <https://simpleflying.com/spicejet-history/>.
[525] *Ibid.*
[526] Hooper, "Liberalization in India", *supra* note 30 at 117.
[527] *Ibid.*
[528] The rupee had depreciated by 115% during 1990-97. Beverly Mathews, "A Look At The Rupee Since 1990", *Business Standard* (27 January 20013), online: <https://www.business-standard.com/article/specials/a-look-at-the-rupee-since-1990-197120801065_1.html>

The carriers also had to invest their own resources in ground handling and security services. New entrants faced a shortage of airport facilities like the availability of adequate terminals. Due to the shortage of airport facilities and congestion in major airports like Mumbai, New, Delhi, Kolkata and Chennai, carriers were required to park their aircraft at the nearest designated airport rather than at their operational bases.[529] This resulted in carriers incurring additional costs of operations and prevented them from adopting a hub-and-spoke approach to building their network. Moreover, due to the intense nature of competition among the Indian carriers, none of them entered into strategic alliances with each other to share resources.

Another peculiar situation which set India's liberalisation strategy apart from its US counterpart was government ownership in Indian Airlines and Air India. Even after deregulation, Air India and Indian Airlines remained wholly owned by the government.[530] Even though there were some thoughts of privatising the carriers during the late 1990s,[531] no clear commitment was made in this regard. Given the losses of these entities, it was difficult for the government to disinvest itself. The interest of the government in the national airlines led to its preferential treatment. These included financial aid given by the government,[532] allocation of slots[533] and infrastructural facilities thereby destroying competitive neutrality among the players. Notwithstanding the poor performance of the carrier, Indian Airlines being the only incumbent scheduled carrier prior to deregulation also had the advantage of a well-developed network and fleet. Taking advantage of the government support, in March 1996, Indian Airlines incorporated a fully owned subsidiary called Airline Allied Services Limited, operating as Alliance Air. The purpose of this subsidiary was to operate flights to tier 2 and tier 3 cities from Delhi, Mumbai, Bengaluru, Kolkata, Hyderabad & Bhopal under the RDG.[534] Indian Airlines transferred most of its older B737 aircraft to Alliance Air to reduce overheads.[535] These older aircraft were used by Alliance Air on low-density routes while Indian Airlines renewed its fleet

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[529] *Ibid.*

[530] ICAO, "List of Government-owned and Privatized Airlines" (04 July 2008), online: *ICAO* < https://www.icao.int/sustainability/documents/privatizedairlines.pdf>

[531] In 1997, the Kelkar Committee recommended measures to improve efficiency of Indian Airlines which included ways to infuse capital. The committee's recommendation was that government should reduce its holding to 49%, and 10.6% and 40.4% should go to the employees and the public respectively. The committee's recommendations were accepted by the government, but no action was taken. Thereafter in May 1999, the government announced its intention to partially privatize Air India, but similarly no action was taken.

[532] Every year the central government allocated funds from the union budget for the national carriers; See India, Ministry of Finance, *Union Budget.*

[533] Given the Indian Airlines is the oldest scheduled carrier, they get preference to airport slot allocation under the grandfather clause; See chapter 3, para 3.4.4, *below.*

[534] "Alliance Air: Regional/Commuter Domestic Only", online: *CAPA Centre for Aviation* <https://centreforaviation.com/data/profiles/airlines/alliance-air-9i>

[535] "Air India to Transfer B747s to Alliance Air" (21 January 2020), online: *CH-Aviation* <https://www.ch-aviation.com/portal/news/85440-air-india-to-transfer-b747s-to-alliance-air-report>

and reduced diversity in its fleet to bring operational efficiency. This gave the Indian Airlines conglomerate, backed by the government, the opportunity to widen its network resulting in a more competitive disadvantage for the newcomers. Apart from this, until 2003, Air India was the only carrier flying on international routes, thereby blocking access to the new entities in the lucrative overseas market.[536]

Due to the unfavourable regulatory environment financial hardships of airlines were a persistent problem. After a few years of profitable operations, airlines started reporting losses which resulted in multiple market failures. Of the notable failures were Damania Airways, East-West Airlines, ModiLuft, and NEPC Airlines, which exited the market before the beginning of the 21st century even after capturing a huge market share.[537]

Apart from the regulatory burden, arguably the most important reason for the failure of the airlines had been internal mismanagement. Most of the airlines that existed did not have a sound business model and were in fact run as family enterprises which lacked the expertise required to run a complex airline business. An evaluation of the ownership structure of the carriers will add weight to this claim. East-West Airlines was set up by Mr Thakiyudeen Abdul Wahid who ran a travel agency in Mumbai. Another major carrier, Damania Airways was founded by Mr Pervez Damania, who ran a poultry business. Similarly, ModiLuft was started by mining baron Mr S K Modi and Lufthansa (which was later forced to pull out). None of them had any experience of running or working in the airline sector. Instead of adopting a sound business plan to run the airlines given the adverse regulatory environment, these carriers focused on redefining the flying experience with their onboard services. CNBC reported that Damania Airways 'ran a gold-plated airline offering terrific on-board service including specially curated meals and beer, a first on domestic flights.'[538] Other poor business decisions leading to failures included East-West Airlines' rapid expansion policy. Its approach of maintaining a fleet of mixed aircraft also proved to be a burden. Similarly, ModiLuft also failed because of its rapid expansion and faulty strategies.[539] Damania Airways had accumulated a debt of USD 20 million since the start of its operations, which led to the grounding of most of

[536] See chapter 3, para 4.3, *below.*
[537] Nagpal & Saranga, *supra* note 507 at 96.
[538] Sundeep Khanna, "Backstory: How pioneers like Damania and Modiluft Kickstarted a Flying Revolution in India?", *CNBC TV* (14 June 2021), online: <https://www.cnbctv18.com/aviation/backstory-how-pioneers-like-damania-and-modiluft-kickstarted-a-flying-revolution-in-india-9483101.htm>
[539] *Ibid.*

its aircraft. It also faced trouble serving the government's uneconomic routes and it was ultimately taken over by NEPC which as well ceased operations in 1997.[540]

Jet Airways and Sahara Airlines were the only private scheduled airlines that remained in competition in the early 2000s along with the national carrier and a handful of regional airlines, and a larger number of air taxi operators. However, they reported heavy losses and continued to face difficulties. Chart 3.2 provides an overview of the financial condition of the scheduled carriers that managed to remain in the market.

Chart 3.2: Net Profit/Loss of Scheduled Indian Carriers (1999-03)

Year	Profit/Loss of Indian Carriers (Rs Million)			
	National Carriers	Jet Airways	Sahara Airlines	All Scheduled Airlines
1999-00	85.8	101.7	-48.8	138.7
2000-01	-108.6	124.8	-349.4	-333.2
2001-02	-2882.8	-134.3	-1598.8	-4615.9
2002-03	-1,434.7	-2,444.5	-377.5	-4,256.7
*National Carriers include Air India, Indian Airlines, Alliance Air				
Source: DGCA, India				

Even today this trend of bankruptcies continues and interestingly none of these carriers flies the skies anymore with the exception of Jet Airways, which is soon launching Jet 2.0 after going through bankruptcy and restructuring.[541]

It seems like poor financial performance leading to bankruptcies and market failures is an unavoidable ugly attribute of deregulation around the world. The ugliest aspect of deregulation in the US had been the financial performance of carriers which resulted in numerous bankruptcies and entities exiting the market. While there have been some periods of highly profitable business, the degree of losses was much higher than the profitability of the overall industry.[542] These financial problems forced many companies to wind up which changed the industry structure. In the US bankruptcies, mergers and acquisitions became a common trait in the market. In the initial ten years after deregulation, the country saw fifty-one mergers.[543] This led to market consolidation and the emergence of oligopolies. Just as one might think that market failures are an immediate consequence of deregulation and with passing years as the market consolidates, the industry players get stronger, the US market witnessed a series of bankruptcies, terminations, mergers,

[540] Hooper, "Liberalization in India", *supra* note 30 at 121.
[541] "Jet Airways 2.0 to Start Commercial Operations from September", *Live Mint* (27 July 2022), online: <https://www.livemint.com/news/india/jet-airways-2-0-to-start-commercial-operations-from-september-11658895820291.html>
[542] Goetz & Vowles, *supra* note 175 at 260.
[543] See chapter 1, para 6.4.1, *above.*

and acquisitions even in the early 21st century, more than two decades after the US Deregulation Act was adopted. Major players like Delta Airlines, Northwest, United, and US Airways (twice) had each declared bankruptcy during the 2000s although they managed to exit bankruptcy without having to cease operations.[544] Other major carriers like TWA was acquired by American Airlines in 2001, US Airways merged with America West in 2005, and Delta Airlines and Northwest merged in 2008. Frontier, Aloha, ATA, and Skybus have ceased operations. The US industries even today continue to witness market failures with at least another fourteen entities filing for bankruptcies between 2016 and to date.[545]

2.3. Airfares

The biggest motivation for deregulation of air transport services in the US was the expectation that potential or actual competition would bring down airfares.[546] Even though the industry witnessed some rise in fares in the early years with an exception of fares on popular routes which went down due to widespread discounting, in the later years average domestic fares showed a diminishing trend.[547] The strategy of new entrants in the US was to provide deep cuts in price and use promotional fares to attract customers which is a feature of a competitive market.[548] On the other hand, routes to the smaller communities with less traffic saw the highest increase in airfares.[549]

The situation in India was different. As per studies, prior to deregulation, regulated fares were half the price of comparable services in the western world.[550] On the other hand, post-deregulation in the period between 1993 and 1995, Indian Airlines increased their fares by 20% and the private airlines followed.[551] At this juncture, it becomes crucial to appreciate the reason why deregulation did not bring a reduction in fares in India on the trunk routes which has otherwise been a characteristic of deregulation in all developed countries. The phenomenon has been that costs of operations fall as traffic on a particular route increases. These costs mostly include the fixed costs incurred by carriers like the cost to enter new routes, traffic and passenger handling costs, staff salaries, marketing and maintenance of aircraft. In a dense market, these costs can be recovered from a large customer base. In the US, airlines reduced

[544] Goetz & Vowles, *supra* note 175 at 260.
[545] "US Airline Bankruptcies" (24 August 2022), online: *Airlines for America* <https://www.airlines.org/dataset/u-s-bankruptcies-and-services-cessations/>
[546] See chapter 1, para 6.1 & 6.2, *above.*
[547] See chapter 1, graph 1.3, *above.*
[548] See chapter 1, paragraph 6.4.4, *above.*
[549] *Ibid.*
[550] S Dasgupta, "Private Airlines Heading for a Shakeout", *The Strairs Times* (03 October 1995).
[551] Hooper, "Liberalization in India", *supra* note 30 at 118-19.

their fares to attract customers on dense routes which in turn reduced their operating costs.[552] A consequence of this pattern was that fares rose on routes that did not have dense traffic. The situation in India had been that 80% of the air traffic was concentrated among the top four airports (Kolkata, Delhi, Bangalore and Chennai – popularly referred to as the golden quadrilateral).[553] However, carriers were mandated to fly a major percentage of their overall capacity to remote parts of the country under the RDG.[554] This uneven distribution of traffic along with the mandate to serve low-traffic routes prevented the carriers from reducing their fares on trunk routes, unlike the US. Carriers in India had to use the profits made on these routes to cross-subsidise and make up for the costs incurred on the Category II and III routes of the RDG.[555] Because of this, Indian carriers were not operating in an efficient way which prevented them from being low-cost carriers. US carriers neither had the mandate to fly to small communities nor to reduce fares on those routes and as a result, they were not required to cross-subsidise their operations.

Another important point of difference was that the US and other developed States were served by many regional airlines which were adequately equipped with smaller aircraft to suit the demand and operate on an efficient economic model. According to the Regional Airline Association, in 2018, 63% of US airports with commercial services were *only* served by regional carriers. The percentage of all scheduled flights operated by regional airlines in the US remained at 41%.[556] Although India had a few regional carriers, the regional airline network was not well developed, and it was the larger airlines that were forced to serve thin markets with inappropriate aircraft which added to their costs. The lack of regional airlines was a key factor behind the difference between India and US vis-à-vis reduction in fares.

2.4. Regional Connectivity

Ensuring air connectivity to remote parts of the country on low dense routes is the biggest challenge for any state undertaking deregulation. The fear is that without any laws governing routes, carriers would choose to fly only on dense routes to ensure profitability. To overcome this problem, the US adopted the Essential Air Services Program in its deregulation act. The intention behind these provisions was to incentivise carriers to fly to smaller communities. The

[552] See chapter 1, para 6.4.4, *above.*
[553] Hooper, "Deregulation: Australia and India", *supra* note 40 at 111.
[554] See chapter 3, para 1.2, *above.*
[555] *Report of Working Group 2012*, *supra* note 518 at para 8.2.2.1.
[556] "Regional Airlines Provide the Critical Link", online: *Regional Airline Association RAA* <https://www.raa.org/the-critical-link/>

government provided subsidies and compensation to airlines to encourage them to continue flying to remote parts.[557] Despite this allowance, data shows that small communities were negatively impacted by a decline in the number and quality of services compared to the era of regulations when flying on these routes were mandatory.[558]

On the other hand, regional connectivity in India was ensured through the RDG. India performed better than the US in terms of maintaining regional connectivity on less popular low-density routes. Scheduled carriers were mandated to fly to remote parts of the country. The rationale behind the RDG was that the Category I routes were largely inter-metro routes and generated surplus which carriers must use to cross-subsidised losses largely on Category II and III routes.[559] Furthermore, Indian Airlines being the government carrier had the highest social responsibility and burden of serving low-density routes. In 1996, only 7.4% of Indian Airlines' routes were direct connections between the busiest five airports which accounted for 80% of the total traffic.[560] Compared to the US, it had neither a government carrier nor a private carrier mandate to fly on these social routes. The only reason India could ensure regional connectivity better than the US was due to the presence of regulation. As per the 'Air Connectivity Report 2011' the RDG was:[561]

> quite successful in providing air connectivity in different parts of the country…. With the increase in the air operations on Category I routes, airlines were bound to increase operations on Category II routes and on non-metro and smaller places under Category III routes. In other words, effective implementation of Route Dispersal Guidelines ensured that airlines fulfil at least some social obligations.

Interestingly the US approach of incentivising carriers through subsidies (The Essential Air Service Program) did not yield the desired results of ensuring regional connectivity. However, as mentioned earlier, the Indian approach of mandating carriers through the RDG came at a very heavy cost of unduly burdening carriers[562] and was one of the important reasons behind the failure of most airlines in India.

3. The Domestic Aviation Industry in the 21st Century (2003 - To Date)

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[557] See chapter 1, para 6.3.4, *above.*
[558] See chapter 1, para 6.4.3, *above.*
[559] India, Ministry of Civil Aviation, *Report on Air Connectivity* (New Delhi: 2011) at 46.
[560] See India, DGCA, *Airline Timetables* (New Delhi: 1996).
[561] *Report on Air Connectivity*, *supra* note 559 at 51.
[562] *Report of Working Group 2012*, *supra* note 518 at para 12.1.28.

3.1. Entry of Air Deccan – India's First LCC

Characterised by market failures and bankruptcies similar to the market in the US, the Indian aviation industry entered the 21st century with only two major private scheduled carriers – Jet Airways and Sahara Airlines along with Indian Airlines and Air India. Inspired by the markets in Europe (RyanAir and Easyjet) and the US (SouthWest JetBlue), the Indian market witnessed changes from the year 2003 onwards when a new type of airline service – Low-Cost Carriers (LCC) – was introduced.[563] Air Deccan was the first to offer low-cost and no-frill services and gave tough competition to the existing Jet-Sahara private duopoly. The perception that air travel was reserved for the elite started to change. Moreover, LCC gave a much-needed boost to the aviation ecosystem, the growth of which had slowed down worldwide due to economic recession, terrorist attacks in several countries including the tragic 9/11, Gulf war and the SARS epidemic.[564]

It would not be inaccurate to state that in India Air Deccan redefined and revolutionised air transport. It introduced a system of dynamic pricing and a small number of customers who booked their tickets early could travel at a price as cheap as one rupee.[565] While industry experts believed that such pricing would wreck the industry, the founder of Air Deccan – Captain G.R. Gopinath (retired-army-officer-turned-businessman) - believed that his airline had not 'only broken the price barrier, but India's caste and class barrier to flying.'[566] In his memoirs, Captain Gopinath wrote 'the one rupee tickets fired the imagination of the people and quickly became a buzzword.'[567]

Through its innovative business model inspired by American and European LCCs but designed to suit Indian conditions, Air Deccan become extremely successful. The carrier targeted leisure, small business and corporate customers belonging to the cost-conscious middle class.[568] It kept its fare comparable to railway tickets and in many cases for early bird customers, it was even lower than train tickets.[569] By keeping its average fare 30% lower than the Full-Service Carriers (FSC), the carrier increased its customer base and managed to remain profitable while offering low fares. By 2006, Air Deccan was flying around two hundred and sixty flights per

[563] Jeffrey L Sampler, "Air Deccan" (2006) Solan School of Management, Massachusetts Institute of Technology, Working Paper No. 365 at 5.
[564] *Ibid* at 4.
[565] Captain G R Gopinath, *Simply Fly: A Deccan Odyssey* (India: Harper-Collins Publishers, 2017) at 520.
[566] Sudha G Titak, "The Man Who Made Flying Affordable to Millions of Indians", *BBC* (14 November 2020), online: <https://www.bbc.com/news/world-asia-india-54927691>
[567] Gopinath, *supra* note 565 at 521
[568] Sampler, *supra* note 563 at 7.
[569] Gopinath, *supra* note 565 at 428.

day across fifty-five airports. It commenced operations to nine destinations not covered by the incumbents and seven of its destinations were serviced by only one other carrier.[570] Through this, it expanded its customer base and faced negligible competition. It adopted several innovating strategies like increasing aircraft utilisation rate which resulted in higher flying hours.[571] The airline meticulously planned its routes and offered point-to-point service instead of connections, thereby eliminating wait time between connections.[572] It maintained a base in eight metropolitan cities which made it easier to fly on various unexplored regional routes.[573] However, before launching new services, the carrier conducted market surveys to identify passenger traffic. As part of its survey, the carrier observed railway traffic and if upper-class train traffic between two destinations was in the range of 500-800 passengers per day, the routes were deemed to be lucrative enough to begin air operations.[574] Its strategy to pursue unexplored routes coupled with its pricing paid off. Air Deccan was aware that it owes its success to its load factor and therefore it maintained a policy of discontinuing services on a particular route within four months if the load factor was low. By 2005, it maintained an average of 80.86% load factor, much higher than its competitors.[575] Other strategies included investing in the aircraft fleet, aggressive cost reduction, marketing and promotions and most importantly on alternative sources of revenue like the sale of food and beverage and advertising on seats, storage cabins, headrests, tray tables, baggage tags, boarding passes, the body of the aircraft and in the inflight magazine.[576] One interesting incident to note was that at that time DGCA did not allow operators to paint aircraft with advertisements except with explicit permission. The founder, Captain Gopinath extensively negotiated with the DGCA to allow Air Deccan to advertise on the body of the aircraft. He finally got the approval and the revenue generated from such advertisements covered more than 50% of the aircraft's monthly lease.[577] Unlike its competitors, the airline did not offer refundable tickets and charged between 10-100% cancellation charges depending on the date of cancellation.[578] Through these innovative strategies and new business models, Air Deccan was able to distort the stagnant Indian aviation market giving tough competition to the incumbents. Many of the strategies adopted by Air Deccan became so popular that to date they are adopted by LCCs in India.

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[570] *Ibid.*
[571] Gopinath, *supra* note 565 at 585.
[572] *Ibid* at 431.
[573] *Ibid* at 558.
[574] Sampler, *supra* note 563 at 8.
[575] *Ibid* at 9.
[576] *Ibid* at 7-11.
[577] Gopinath, *supra* note 565 at 473-74.
[578] Sampler, *supra* note 563 at 9.

3.2. Changing Regulatory Landscape

Notwithstanding the much-needed boost that came with the launch of Air Deccan, there were several problems plaguing the Indian aviation industry primarily due to regulatory burdens. In 2003, the Ministry of Civil Aviation set up a committee – 'The Naresh Chandra Committee' - to revise the civil aviation policies and make recommendations for the development of civil aviation.[579] The committee submitted its recommendations suggesting dramatic changes to further liberalise the market. Based on the committee's report, the government initiated various measures to promote and develop the aviation sector.

Some of the noteworthy recommendations of the committee included encouraging private participation and competition among airlines, reducing entry barriers, privatisation of the national carriers, lowering taxes on ATF, removal of aviation-related taxes and fees like Inland Air Travel Tax, Foreign Travel Tax and Passenger Service Fee and permitting foreign investment up to 49%. It also recommended the removal of the RDG and replacing it with a non-lapsable Essential Air Services Fund to provide subsidies (similar to that in the US). With regards to the liberalisation of international air transportation, the committee recommended a two-step process – the first step would involve allowing private carriers to fly on international routes and in the second step India should negotiate liberal bilateral ASAs with foreign countries.[580]

Based on these recommendations, the government took a slew of measures to gradually implement the recommendations which eventually further liberalised the Indian aviation sector. The measures paved the way for a change in the domestic market structure which further boosted the industry.

3.3 Change in Market Structure

The period post-2003 marked a new era for aviation in India – the era of LCCs. Air Deccan created a huge market for LCCs, and its success led to the entry of other LCCs in the Indian market namely Paramount, SpiceJet, GoAir and IndiGo in this period.[581] Even Air India went on to launch a wholly owned subsidiary based on the LCC model in 2005 - Air India Express - with the objective of providing convenient low-cost connectivity on short and medium-haul international routes to the Gulf and Southeast Asian countries. It provides no-frill low-cost

[579] India, Ministry of Civil Aviation, *Report of the Committee on a Road Map for the Civil Aviation Sector* (New Delhi: 2003) [*Naresh Chandra Committee Report*].
[580] *Ibid* at chapter 7.
[581] *Report of Working Group 2012*, *supra* note 518 at para 8.1.7.3.1.

services to its customers.[582] The launch of LCCs reaped the real benefits of deregulation in India. The 'Air Connectivity Report 2011' noted that the entry of LCCs led to 'strong economic growth, increased FDI inflows, surging tourist inflow, increased cargo movement, sustained business growth and supporting government policies.'[583] Unlike the initial phase post deregulation characterised by an increase in fares and poor financial performance featuring market exits, airfares actually reduced, and the number of passengers was on the rise in the era of LCCs.[584] Connectivity was also boosted as the LCCs commenced operations on the unexplored routes. Alongside LCCs, the sector was catered to by a few FSCs including incumbents like Jet Airways and Sahara Airlines. New FSCs like Kingfisher Airlines and MDLR also entered the market.[585] Liberalisation of aviation policies eventually paid off as opposed to the fear that deregulation might not bring the desired results. There was an increase in the number of highly profitable airlines. The number of passengers grew from 13.1 million in 2001 to 36.23 million by the end of 2006. Of the passengers ferried in 2006, the market share of LCCs alone was 28.9 million passengers.[586]

The price-sensitive Indian market provided the perfect customer base for the budget airlines. They were also able to reduce travel time by providing better connectivity, more destinations and shorter turnaround times.[587] As airfares were comparable to railway fares, they were successful in diverting railway traffic by offering significantly lower travel time which increased the passenger share. Competition among the airlines played a role in reducing fares and increasing connectivity for the ultimate benefit of customers. Moreover, the Indian government's motive behind deregulation which was to cater to the issue of capacity shortage was also addressed.

Interestingly, competition from the LCCs positively affected Indian Airlines as well. It brought several changes to its management and improved its quality of services and punctuality.[588] These steps taken by Indian Airlines in the wake of new competition brought hope for the government carrier. As evident from Chart 3.3, Indian Airlines turned from being a loss-making entity to a profitable one in the era of LCCs (2003 onwards). It also increased its

[582] "About Air India Express", online: *Air India Express* <https://www.airindiaexpress.in/en/about-us/our-company>
[583] *Report on Air Connectivity*, *supra* note 559 at 9.
[584] See chapter 3, chart 3.4 & 3.7, *below.*
[585] *Report of Working Group 2012*, *supra* note 518 at table 31.
[586] Mazumdar, *supra* note 450 at 57.
[587] *Report of Working Group 2012*, *supra* note 518 at 8.1.7.2.1.
[588] Mazumdar, *supra* note 450 at 61.

Chart 3.3: Total Passenger Traffic and Profit/Loss of Indian Airlines (2001-07)		
Year	**Passenger Traffic (No.)**	**Profit/Loss (Rs Million)**
2001-02	5,503,767	-2467.5
2002-03	5,637,916	-1965.6
2003-04	5,876,653	441.7
2004-05	7,103,533	656.1
2005-06	7,820,908	495
2006-07	8,506,508	-2402
Source: DGCA, India		

passenger traffic. This trend continued till 2006 with an exception to its last year of operations before being merged into Air India in 2007.

In the year 2007, the sector was headed towards a phase of consolidation. In April 2007, Jet Airways acquired Sahara Airlines for USD 340 million and restructured Sahara Airlines' operations and renamed it JetLite. India's first LCC, Air Deccan, was acquired by FSC Kingfisher Airlines in June 2007. Furthermore, the government carriers Air India and Indian Airlines were merged and operated under the name Air India from 24 July 2007. Carriers like Paramount and MDLR which were launched in the same decade ceased operations.[589] Notwithstanding this market consolidation, domestic traffic continued to increase.

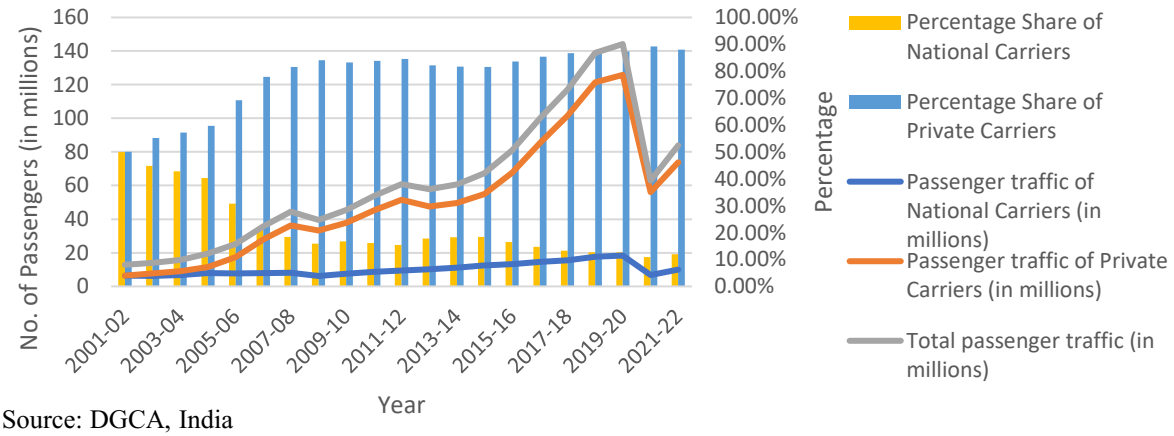
The second decade of the 21st century witnessed the failure of India's premium FSCs Kingfisher Airlines in 2012 and Jet Airways in 2019. Several reasons led to the decline of Kingfisher Airlines, the major one being attributed to its acquisition of Air Deccan.[590] Moreover, the founder of Kingfisher Airlines – Mr Vijay Mallya – being a liquor tycoon was more interested in advertising his Kingfisher beer brand through his airline. Passengers were treated with lavish onboard meals and plenty of Kingfisher beer.[591] He failed to appreciate the differences between the two industries and focused on making air travel luxurious rather than focusing on cost-cutting mechanisms. This led to poor decision-making, causing its downfall.[592] Heavy regulatory burden and high taxes were also contributing factors.[593] Similarly, Jet Airways had to shut down operations due to financial mismanagement leading to losses and accumulation of huge debt.[594]

The same decade also saw several new entries. Two new airlines were launched by the Tata Industries – one LCC - AirAsia India and one FSC – Air Vistara. In the year 2016, the

[589] *Report of Working Group 2012*, *supra* note 518 at table 31.
[590] Ashok Panigrahi *et al,* "A Case Study of the Downfall of Kingfisher Airlines" (2019) 6:2 J Management Research & Analysis 81 at 83.
[591] Sumit Singh, "What Went Wrong with Kingfisher Airlines?" (20 October 2022), online: *Simple Flying* <https://simpleflying.com/what-went-wrong-kingfisher-airlines/>
[592] Panigrahi, *supra* note 590 at 84.
[593] *Ibid.*
[594] Graham Rapier, "India's 2nd Largest Airline is Shutting Down After Running Out of Money", *Business Insider* (17 April 2019), online: <https://www.businessinsider.com/jet-airways-shuts-down-after-running-out-of-money-2019-4>

government started issuing a new type of Air Operator Permit (AOP) called Scheduled Commuter Carriers[595] which prompted several regional airlines to enter the business, including TrueJet, Star Air, FlyBig, Air Taxi and IndiaOne Air.[596] LCCs like SpiceJet, GoAir and IndiGo, who had already commenced business, geared up their operations and their market share kept increasing. Gradually capturing the market, IndiGo became India's largest operator both in terms of passenger traffic share and number of flights operated.[597] With multiple new entries of different types of scheduled carriers and with LCCs dominating India's price-sensitive market, the decade witnessed a strong rise in domestic passenger traffic. The launch of the Regional Connectivity Scheme (RCS) in 2016-17 also contributed to the increase in passenger traffic on regional routes.[598] The year 2020-21 experienced a huge dip in passenger traffic attributable only due to the Covid-19 pandemic; however, the following year the industry made recovery. Chart 3.4 shows the increase in total domestic traffic and market share of national and private scheduled operators during this era.

Chart 3.4: Domestic Traffic and Share of National and Private Scheduled Indian Carriers (2001-21)



Source: DGCA, India

As evident from the above chart, domestic traffic continued to increase along with the market share of private scheduled carriers. At the same time, the national carrier's share was reduced to a mere 12% in 2021. With the bankruptcies of FSCs like Kingfisher and Sahara Airlines and the entry of several LCCs by 2014, more than 50% share of the domestic traffic was in the hands of the LCCs and the share kept increasing. Chart 3.5 shows the market share of LCCs, FSCs and regional carriers between 2014 and 2021.

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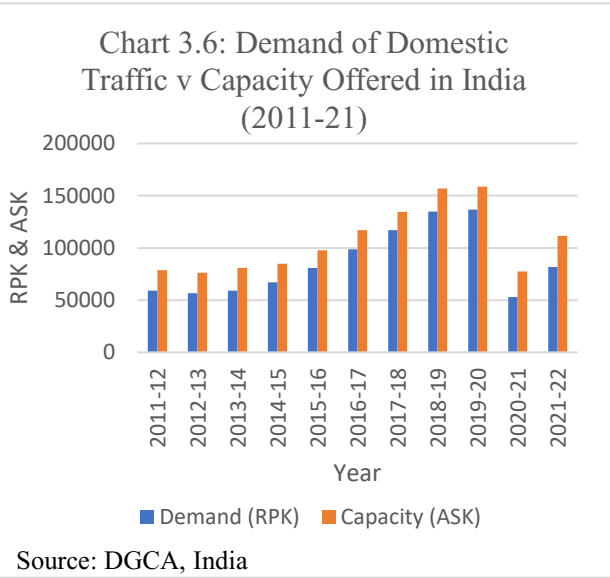
[595] India, DGCA, *Civil Aviation Requirement Section 3 - Air Transport Series C Part XII – Requirements for Grant of Air Operator Certificate for Scheduled Commuter Air Transport Services,* F. No. 14015/14/2016- AT1 (2016) [*CAR Section 3 Series C Part XII*].
[596] India, DGCA, *Handbook on Civil Aviation Statistics 2021-22* (New Delhi: 2022) at 9 [*DGCA Handbook 2021*].
[597] *Ibid.*
[598] India, Ministry of Civil Aviation, *Regional Connectivity Scheme* (December 2016).

Chart 3.5: Market Share and Number of FSCs, LCCs and Regional Carriers in India (2014-21)			
Year	Percentage Share of FSCs (Number of Carriers)	Percentage Share of LCCs (Number of Carriers)	Percentage Share of Regional Carriers (Number of Carriers)
2014	35.8% (2)	62.8% (5)	1.4% (1)
2015	36.9% (3)	62% (5)	1.1% (3)
2016	33.4% (3)	65.4% (5)	1.2% (4)
2017	31.8% (3)	67.8% (5)	0.4% (2)
2018	30.3% (3)	69.4% (5)	0.3% (3)
2019	20.2% (2)	79.2% (4)	0.6% (4)
2020	17.1% (2)	82.2% (4)	0.7% (4)
2021	20.1% (2)	79.9% (4)	0.6% (5)
Source: DGCA, India			

The dominance of LCCs continues even in the current decade. By the end of 2021, the market share of LCCs stood at 79.9% of India's total domestic scheduled passenger traffic with IndiGo occupying a whopping 54.8% market share. The market share of FSCs stood at 20.1%. Noteworthyly, till 2021 India's domestic market was served by only two FSCs – Air India and Air Vistara and four LCCs.[599]

A combined reading of Charts 3.4 and 3.5 proves the low-price LCC business model along with the easement of regulations as per the suggestions of the Naresh Chandra Committee led to a tremendous increase in domestic passenger traffic and deregulation eventually paid off after a few initial years of turmoil. Not only did the domestic sector witness an increase in traffic but also the issue of capacity shortage was solved. Chart 3.6 compares the demand for domestic traffic (measured in Revenue Passengers Kilometre) v. capacity offered (measured in Available Seat Kilometre). Between 2011-12 to 2021-22, while the capacity (ASK) in the domestic market grew at a rate of 3.5% compounded annually, the demand (RPK) grew at 3.3% during the same period.



Source: DGCA, India

Over the years with the dominance of LCCs in the Indian aviation market, airfares also saw a huge reduction. Chart 3.7 demonstrates the relative decrease in airfares compared to the 2005 level, indexed to inflation.[600] Data is available till 2019 when fares were freely determined by

[599] *DGCA Handbook 2021*, *supra* note 596 at 9.
[600] IATA, *India's Air Transport Sector: The Future is Bright but Not Without its Challenges* (Geneva: 2018) at 3.

market forces. Between 2020-2021, in light of the Covid-19 pandemic, the government had regulated airfares which now stand withdrawn.[601]

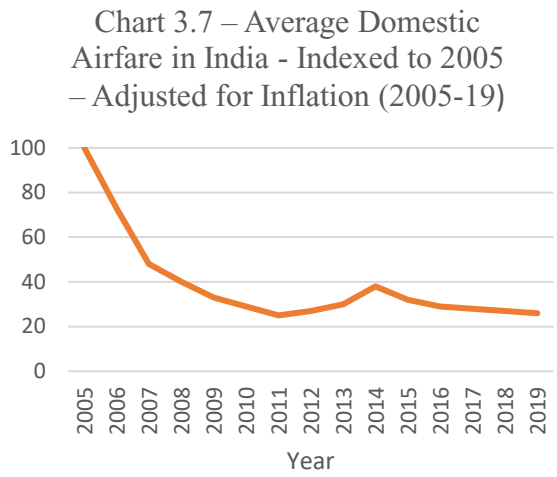


Chart 3.7 – Average Domestic Airfare in India - Indexed to 2005 – Adjusted for Inflation (2005-19)

Source: IATA

Two years into the current decade, the industry has been nothing less than dramatic. The key highlight of this decade is the disinvestment and privatisation of Air India. The primary reason for the disinvestment was the poor performance of Air India at the expense of taxpayers' money and accumulating debt. Interestingly, Tata Industries won the bid and regained control in January 2022, after almost seventy years since the government took Air India from them upon the event of nationalisation. As part of the deal, the government received about USD 360 million in equity and the Tata Industries took more than USD 2 billion of Air India's debt.[602] The deal includes three entities - FSC Air India, its low-cost arm Air India Express and AI SATS, which provides ground-handling and cargo services.[603] Air India's wholly-owned subsidiary, Alliance Air, which flies on regional routes was kept out. With this, the Tata Industries now operates three airlines in the country – Air India (100% ownership), Air Vistara (joint venture with Singapore Airlines holding 49% equity) and AirAsia India (AirAsia Investment Limited, Malaysia held 16.33% stake which it sold of Air India in November 2022[604]). Alliance Air remains the only government-owned scheduled airline, though plans to sell the entity have already begun and will be disinvested shortly.[605]

In another major development, a new LCC, Akasa Air, backed by late ace investor Mr Rakesh Jhunjhunwala, has already commenced operations in 2022. Mr Vinay Dube – former CEO of Jet Airways – is the co-founder and CEO of Akasa Air.[606] Furthermore, Jet Airways is set to relaunch in late 2023 after going through corporate restructuring. The revival plan submitted

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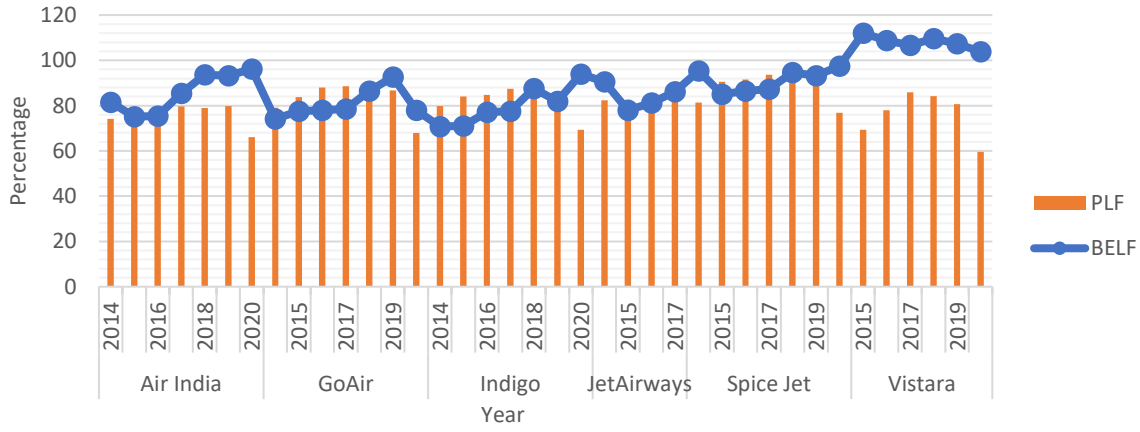
[601] India, Ministry of Civil Aviation, *Order Number 28/2022* (10 August 2022).
[602] Aditi Shah, "Tata Regains Air India Control in Privatization Victory for Modi", *Reuters* (27 January 2022), online: <https://www.reuters.com/world/india/tata-group-takes-control-air-india-2022-01-27/>
[603] India, Ministry of Finance, Press Release, 1792950 "Air India Strategic Disinvestment Completed" (27 January 2022), online: *Press Information Bureau* <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1792950>
[604] "AirAsia sells remaining stake in AirAsia India to Air India", *Outlook* (02 November 2022), online: <https://www.outlookindia.com/business/airasia-sells-remaining-stake-in-airasia-india-to-air-india-news-234284>.
[605] Sidhartha & Saurabh Sinha, "Govt Starts Work on Sale of Alliance Air, other ex-AI cos", *Times of India* (27 July 2022), online: <https://timesofindia.indiatimes.com/business/india-business/govt-starts-work-on-sale-of-alliance-air-other-ex-ai-cos/articleshow/93148121.cms>
[606] "What is Akasa Air", *Business Standard,* online: <https://www.business-standard.com/about/what-is-akasa-air>

by a consortium of London-based Kalrock Capital and the UAE-based businessmen Mr Murari Lal Jalan has been approved by the National Companies Law Tribunal and Jet Airways 2.0 is set to return to the skies.[607] It has already acquired fresh AOP and got the DGCA nod to take off.[608]

Notwithstanding the flowery picture of the growth and development of the domestic aviation sector, most airlines have struggled to be financially sustainable. The following chart compares the Passenger Load Factor (PLF) and Break-Even Load Factor (BELF) of the major airlines in India between the period 2014-2020. While a high PLF implies that the airline is selling more available seats, the airline is running losses if the PLF is less than the BELF.[609] With the exception of IndiGo and GoAir, most of the other airlines were not operating at a PLF higher than the BELF in several years, indicating the carriers were bearing losses. The unexceptional result in 2020 where none of the carriers crossed the BELF was a consequence of the pandemic.

Chart 3.8: Passenger Load Factor v Break-even Load Factor of Major Indian Airlines (2014-20)



Source: DGCA, India

This finding is consistent with the financial performance of the carriers in the same period which shows that most airlines have failed to generate adequate profits after tax (Chart 3.9). Air India has reported the highest amount of losses while IndiGo has been the most profitable airline. However, the overall losses of the industry in this period exceed the profits made indicating that the aviation industry is still a loss-making one.

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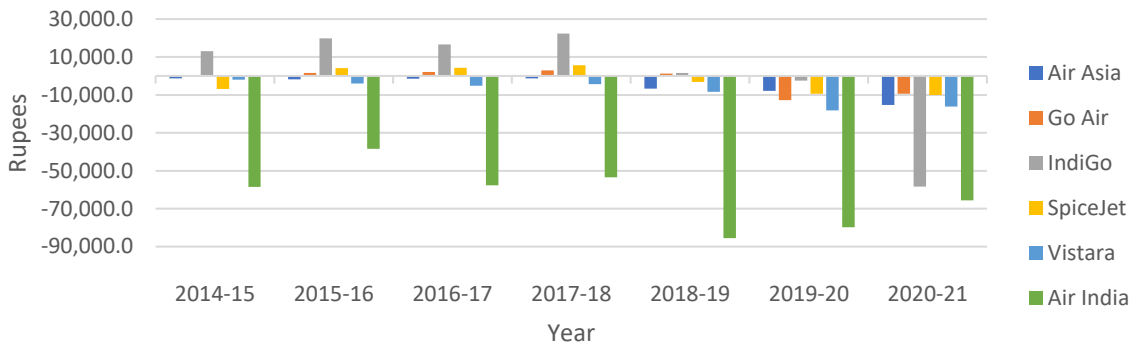
[607] *State Bank of India v Jet Airways India Ltd*., [2019] IA No. 2081 of 2020 in CP (IB) No. 2205/MB/2019 National Company Law Tribunal Mumbai Bench (India).

[608] "Jet Airways gets DGCA Nod to Fly Again", *The Economic Times* (20 May 2022), online: <https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/jet-airways-gets-dgca-nod-to-fly-again/videoshow/91691479.cms>

[609] *DGCA Handbook 2021*, *supra* note 596 at 22.

Chart 3.9: Financial Performance of Major Indian Airlines – Net Profit/Loss after Tax



Source: DGCA, India

3.4. India's Current Aviation Policies and its Impact on the Market: Comparison and Recommendations

This section provides a synopsis of the current aviation policies in India and an analysis of how these policies affect the industry in today's liberalised environment. The analysis also includes a comparison of the policies with India's counterpart US and some recommendations in light of India's developmental needs to boost competitiveness which is a feature of any liberalised market.

3.4.1. Entry Requirements

Rule 134(1) of the Aircraft Rules 1937 specifies that no person shall operate scheduled air transport services in India without the permission of the central government. An application to operate scheduled air transport services is subject to the requirements of Schedule XI of the Aircraft Rules and the Civil Aviation Requirement (CAR), which contains the minimum requirements for the grant of a licence to operate scheduled services. The Directorate General of Civil Aviation (DGCA) is responsible for granting Air Operator Permit (AOP) subject to these provisions.

According to Schedule XI, an AOP can only be granted to a citizen of India, or a company or a body corporate provided that it is registered and has its principal place of business within India, its chairman and at least two-thirds of its directors are citizens of India, and its substantial ownership and effective control is vested in Indian nationals. The schedule also requires that the applicant obtain a No Objection Certificate (NOC) from the central government for the proposed air transport service. To obtain the NOC, the applicant needs to provide *inter alia* details of proposed operations, a project feasibility report regarding the proposed routes of operations, proposed financial structure, acceptable proof of the ability of the applicant to run

air services on a sustained basis, ownership pattern of the applicant, including foreign investments, if applicable, time frame in which the applicant proposes to operationalise the various stages of the project and aircraft type to be used and its suitability for passenger services.[610] While granting the NOC, the central government would take into consideration 'the financial soundness of the applicant, the operational plan, the clearance from security angle of the applicant organisation including its directors, and any other factor that may have a bearing on the proposed air transport services from policy angle.'[611]

Apart from proving financial soundness and the ability to operate an airline, there are other capital and equity requirements as well. An operator that applies for scheduled services and proposes to use aircraft with take-off mass over 40,000 kg must have purchased or leased at least five aircraft and have paid-up capital of Rs 500 million and for each addition of up to five aircraft, an additional equity investment of Rs 200 million would be required.[612] Operators proposing to operate with aircraft less than 40,000 kg take-off mass must have paid-up capital of Rs 200 million and at least five aircraft in their fleet. For each addition of up to five aircraft, an additional equity investment of Rs 100 million would be required. There is, however, an exception to this rule which allows operators to commence operations with one aircraft provided they meet the minimum requirement within one year of operations.[613] For non-scheduled operators, the requirement is minimal and requires having only one aircraft and equity requirement based on the number of aircraft in the fleet.[614]

For the grant of an AOP, there are other requirements of organisation and personnel as well. The applicant shall have an organisation to the satisfaction of the DGCA and must disclose the duties, responsibilities and authority of the post-holders (managerial employees).[615] It is also required to have at least three sets of DGCA-approved crew per aircraft[616] along with technical personnel.[617]

A starting point of deregulation in most countries has been the free entry and exit of airlines. The key objective of any deregulation is to liberalise entry to assist in the growth of the

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[610] India, DGCA, *Civil Aviation Requirement Section 3 - Air Transport Series C Part II Minimum Requirements for Grant of Air Operator Certificate to Operate Scheduled Air Transport Services (Passenger)*, F. No. AV.14027/09/2021-AT.1 (2022) at para 5 [*CAR Section 3 Series C Part II, 2022*].
[611] *The Aircraft Rules, 1937* at schedule XI 5(3) (India).
[612] *CAR Section 3 Series C Part II, 2022*, *supra* note 610 at para 3.2(i) and 7.2.
[613] *Ibid* at para 7.3.
[614] *Civil Aviation Requirement Section 3 - Air Transport Series C Part III - Minimum Requirements for Grant of Permit to Operate Non-Scheduled Air Transport Services,* F. No. AV.14027/02/2002-AT.1 (2010) at para 4.2.
[615] *CAR Section 3 Series C Part II, 2022*, *supra* note 610 at para 8.
[616] *Ibid* at para 8.5.
[617] *Ibid* at para 8.6.

market.[618] This does not seem to be the case in India. The regulations on equity and fleet requirements not only create a high entry barrier but are also unnecessary. It limits the number of entrants to the market thereby reducing potential and actual competitiveness. Incumbent players are aware of such barriers and their business decisions are taken with the assumption that there is a low chance of entry of new market competitors. Given that in India there are relatively few major scheduled airline operators, there exists no threat that the market share of the incumbents could be reduced by a new entry. Therefore, the incentive to improve services and reduce fares is limited as competition is restricted only between the existing players.

The only possible justification for the fleet and equity requirements is that the government wants to ensure the financial viability of the new entrant to reduce market failures. Governments in other countries with free entry also ensure financial viability. For example, in the US, initially the CAB and now the DOT grants licences for new route entries only if the applicant can prove that it is fit, willing, and able to perform such transportation properly and to conform to the provisions of the act and the rules, regulations, and requirements.[619] However, there are no fleet and equity requirements. In India, along with fleet and equity requirements, the government also maintains oversight over the financial soundness and operational plans of a new entrant. The applicant is required to furnish information about their financial and operational viability for obtaining the NOC. These disclosures sufficiently demonstrate the potential entrant's knowledge of the Indian aviation market and the availability of funds. Additional requirements of fleet and equity to prove financial viability does not guarantee that an airline would not fail as evidenced by the number of airlines that have gone bankrupt. Moreover, market consolidation and free exits are features of any deregulated airline market wherein carriers that are unable to survive in the competitive environment with sound business practices either exit the market or get acquired/merged. Therefore, fleet and equity requirements do not serve any purpose other than increasing the difficulty to start scheduled airline operations. In this light, it is recommended that the requirement to prove financial and operational viability is sufficient and that an additional barrier of fleet and equity is unnecessary and should be done away with.

[618] Hooper, Hutcheson & Nyathi, *supra* note 2 at 398.
[619] See chapter 1, para 6.3.1, *above.*

3.4.2. Routes

As mentioned earlier, the primary challenge of any deregulation is to ensure connection to remote parts of the country. Since the initial days of deregulation in India, connectivity was ensured through the RDG first adopted in 1994 and subsequently amended to enhance connectivity by adding more routes under each category. The RDG as it currently stands (effective from 2017) divides routes into four categories – Category I, II, IIA and III. Category I routes are the profitable trunk routes with 'flying distance of more than 700 km, average seat factor of more than 70% and annual traffic of 5 lakh passengers over two full schedules (i.e., summer and winter).'[620] The RDG categorically lists down the city pairs under this category which currently stands at twenty direct connections. Category II routes are those connecting stations in the North-eastern Region, Jammu and Kashmir, Himachal Pradesh, Uttarakhand, Andaman & Nicobar and Lakshadweep while Category IIA routes are those connecting within Category II stations in addition to Cochin-Agatti-Cochin. Category III comprises all the remaining routes. As per the last order on RDG, carriers are required to deploy an additional 10% capacity of the capacity deployed on Category I routes on Category II routes and an additional 10% on Category IIA routes of the capacity deployed on Category II routes. Category III routes demand a deployment of 35% (reduced from the earlier requirement of 50%) of the capacity deployed on Category I routes.[621] Therefore, scheduled carriers are required to operate an additional 46% of the capacity it operates on trunk routes on the remote regional routes. It is reiterated that the RDG neither provides for any restrictions or caps on fares nor provides for subsidies by the government or other stakeholders. Carriers are expected to internally cross-subsidise the costs of operations on the remote routes. Routes in every category are revised every five years.[622] The RDG, although adds a financial burden to the carriers, has been successful in maintaining connectivity to remote parts of the country.

3.4.2.1. Regional Connectivity Scheme (RCS)

In a recent development, the Government of India has adopted the National Civil Aviation Policy 2016 (NCAP)[623] with the objective of providing affordable and sustainable air travel to the mass.[624] The policy covers a range of issues aimed at further developing the air travel

[620] *NCAP*, *supra* note 44 at para 7(a).
[621] India, Ministry of Civil Aviation, *Route Dispersal Guidelines (RDGs)*, F. No. AV. 18011/1/2016-DT (08 August 2016). [*RDG 2016*].
[622] *NCAP*, *supra* note 44 at para 7(d).
[623] *Ibid.*
[624] *Ibid* at para 2.

industry, of which the noteworthy ones are covered in subsequent sections. One of the most important provisions of the NCAP is the launch of the Regional Connectivity Scheme (RCS) or the UDAN (*Ude Desh ka Aam Naagrik* – which translates to 'Let the Common Citizens of the Country Fly').[625] This scheme was introduced to boost regional connectivity in addition to the RDG. Unlike the RGD, RCS is a more comprehensive programme with provisions for route allotment to carriers, fare caps and subsidies. It aims to enhance regional connectivity through fiscal support and infrastructure development. The scheme was first launched in 2016 and is currently in the fourth phase of implementation.[626] The Ministry of Civil Aviation had earlier released three versions of the Scheme, in December 2016 ('Version 1.0'), September 2017 ('Version 2.0'), and October 2018 ('Version 3.0').

The scheme, implemented by the Airport Authority of India (AAI),[627] aims to revive un-served and under-served airports.[628] The scheme applies to RCS routes which are defined as non-stop air service connections between an identified pair of origin and destination of which at least of one the points is an unserved or underserved airport and is identified as an RCS concession airport.[629] An RCS concession airport is an airport under the RCS scheme where the state government and the airport operator agree to provide concessions for the operations of RCS flights.[630] Concessions from the state government include a reduction of the state tax to 1% or less on ATF for a period of ten years; provision of providing minimum land, if required, free of cost and free from all encumbrances for the development of RCS airports; security and fire services provided free of cost; and electricity, water and other utility services provide at substantially concessional rates.[631] Concessions by airport operators include waiver of landing and parking charges; and route navigation charges at a discount of 42.50% of the normal rates.[632] Even the central government grants concessions for operations on RCS routes by levying a reduced excise duty of 2% on ATF for a period of three years.[633]

Under the scheme, the implementing agency (AAI) selects an airline to serve on the RCS routes following a bidding process where airline operators bid to serve on certain RCS routes.[634] To bid for a route, the applicant needs to submit a proposal ('Initial Proposal') either for an

[625] *Ibid* at para at 4.
[626] India, Ministry of Civil Aviation, *Regional Connectivity Scheme Version 4.0.* (2019) [*RCS 4.0*].
[627] *Ibid* at para 3.1.1.2.
[628] *NCAP*, *supra* note 44 at para 4(c).
[629] *RCS 4.0*, *supra* note 626 at para 1.4.1.19 read with para 2.2.
[630] *Ibid* at para 1.4.1.16.
[631] *Ibid* at para 2.1.2.3.
[632] *Ibid* at para 2.1.2.5.
[633] *Ibid* at para 2.1.2.2.
[634] *Ibid* at para 1.4.1.21 read with 3.1.1.

individual RCS route ('Individual Route Proposal') or for a set of connected routes ('Network Proposal').[635] Of the proposals submitted, the implementing agency identifies the RCS routes proposed as part of an Individual Route Proposal or a Network Proposal.[636] Thereafter the implementing agency invites counter proposals against the initial proposals[637] and after the evaluation of applicants based on set criteria, one operator is selected for a tenure of three years for a particular RCS route.[638] The selected operator is issued a Letter of Award (LoA) with the terms and conditions of operation as per the scheme and is called the Selected Airlines Operator (SAO) for that particular RCS route. The SAO is granted exclusivity of operations on the RCS route. If any other airline operators intend to operate flights on an RCS route, they are required to obtain a No Objection Certificate from the SAO.[639]

The SAO must meet the minimum performance specifications with respect to RCS operations whereby the operator needs to provide a certain capacity of the aircraft as RCS seats (seats on which the RCS airfare cap applies). The scheme explicitly mentions the minimum seats to be made available as RCS seats depending on the type of aircraft. Once the minimum performance specifications are met, other seats can be operated as non-RCS seats without any fare cap. They are also required to fulfil the minimum number of flight operations per week.[640]

The two-fold objective of the RCS – affordability[641] and sustainability[642] – is ensured through fare caps on RCS seats and concessions. With respect to airfare caps, Annexure 2 of the RCS Version 4 (current version) explicitly mentions the airfare cap for each RCS seat for the respective length of the RCS routes. The lowest airfare cap is Rs 1661 for an RCS route less than 50 km, and the maximum airfare cap is Rs 3241 for a distance between 576 – 600 km. Similar caps are also issued for helicopters depending on the duration of the journey on an RCS route.[643]

Sustainability of the airline is ensured through concessions given by the central and state governments and airport operators as mentioned above. Apart from these concessions, the SAOs are also compensated for any losses on the operations on the RCS routes due to gaps in cost and revenue through the Viability Gap Funding (VGF). The VGF is funded by the central

[635] *Ibid* at para 3.2.1.
[636] *Ibid* at para 3.7.
[637] *Ibid* at para 3.8 read with 3.9.
[638] *Ibid* at para 3.1.1. read with 3.10.
[639] *Ibid* at para 2.8.
[640] *Ibid* at para 3.3.
[641] *Ibid* at para 1.2.
[642] *Ibid* at para 1.3.1.6.
[643] *Ibid* at annex 2.

and state government in the ratio of 80:20 (90:10 for North-eastern states). The centre's share of VGF is provided through the Regional Connectivity Fund (RCF)[644] which is funded by a levy charged on all Category I and III routes of the RDG and other sources as may be notified.[645] The RCF, thus, channels funds generated from the sector to stimulate further growth and development of the regional sector. The VGF is provided on a particular RCS route for a period of up to ten years from the commencement of operations by an airline.[646] The amount of VGF paid is capped per RCS seat depending on the length of the RCS route and the type of aircraft used by the SAO.[647] This amount of VGF per seat is explicitly stated in Annexure 3. To keep a check on the VGF provided and boost competitiveness, the implementing agency while selecting the SAO for a particular RCS route prefers the applicant that either requests no VGF or the least VGF among other applicants.[648] The tenure of the scheme is ten years with the objective to make air transport to unserved and underserved airports sustainable.[649] Accordingly, VGF is proposed to be provided for a limited period with a review every three years to encourage sustainability of operations under the RCS in the long term, such that the connectivity established is not perpetually dependent on VGF.[650]

3.4.2.2. Impact of RCS

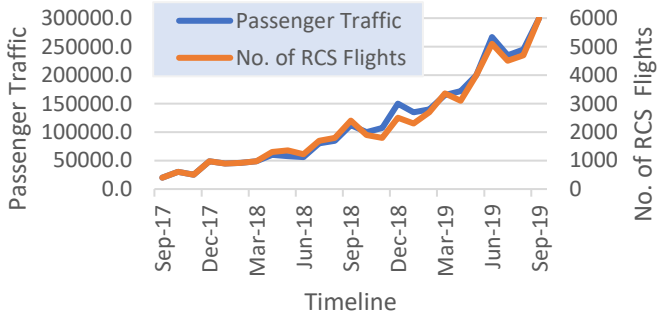
The RCS scheme has done a tremendous job of boosting air connectivity and reviving unserved and underserved airstrips and airports. Prior to the launch of this scheme, hundreds of airports were either used sparingly or were not used for commercial services at all and most of them were located in remote parts of the country.[651] With its dual objective of affordability and sustainability, the scheme not only revived these airports but also increased the share of air traffic. The target of the scheme is to operationalise one hundred underserved and unserved airports and start at least one thousand RCS routes by 2024.[652] Currently, RCS version 4.4 is in effect and as per the latest information published by the implementing agency AAI, seventy out of the target one hundred airports[653] and four hundred and thirty-nine out of the proposed

[644] *NCAP*, *supra* note 44 at para 4(h).
[645] *Ibid* at para 4(j).
[646] *Ibid* at para 4(g)(6).
[647] *RCS 4.0*, *supra* note 626 at para 2.5.
[648] *Ibid* at para 3.11.
[649] *Ibid* at para 2.1.4.1.
[650] *Ibid* at para 1.3.1.6. read with 2.1.4.5.
[651] India, Ministry of Civil Aviation & ISB, *The Regional Connectivity Scheme, UDAN: Progress and Prospects* (New Delhi: 2021) at 5 [*UDAN Report*].
[652] ICRA, *Second Wave to Further Delay UDAN Progress: Stressed Financial Health of Airline Operators to Impact Existing Route Operations and Future Bidding: ICRA* (India: July 2021) [*ICRA Report*].
[653] Airport Authority of India, Press Release, "List of RCS Airports Operationalized" (07 October 2022), online: <https://www.aai.aero/sites/default/files/rcs_news_notifications/70-RCS_Airports_operationalized_as_on_07.10.2022.pdf>

one thousand RCS routes have been operationalised as on 07 October 2022.[654] As per reports, the 2024 target might not be achieved primarily due to the effects of the Covid-19 pandemic on the airline industry, however, the target is achievable by 2026 (a delay of two years).[655]

Apart from the operationalisation of airports and increasing RCS route flights, data available up to the pre-pandemic level reveals the success of RCS in terms of passengers carried under the scheme.[656] The following chart (Chart 3.10) reveals the increase in RCS passengers and the number of RCS flights between 2017 and 2019. The steep increase in both passenger traffic and the number of flights on RCS routes demonstrates its success in connecting remote parts of the country.

Chart 3.10: RCS Passenger Traffic and Number of RCS Flights (2017-19)

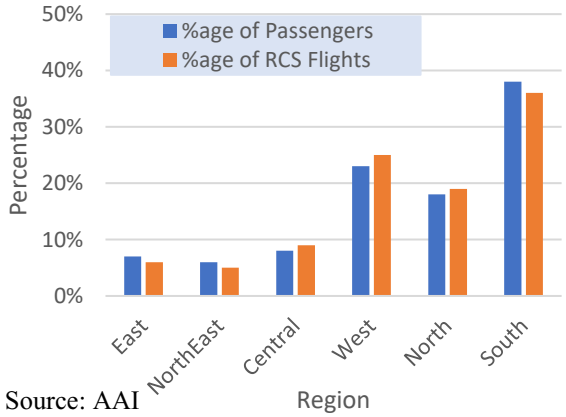


Source: AAI

A regional analysis of RCS reveals that the Southern part of India benefitted the most followed by the Northern, Western, and Central parts. Eastern and North-eastern parts seem to have the lowest numbers.[657] Chart 3.11 shows the percentage distribution of passengers and flights by region.

To make up for the underperformance of the North-eastern region and a few other destinations, RCS version 2.0 declared a newly created category of 'priority areas' including Jammu and Kashmir, Himachal, Uttarakhand, North-east, Andaman and Nicobar Islands and Lakshadweep Islands. The priority areas are eligible for added benefits *viz* higher number of flights,[658] and longer tenure of funding.[659]

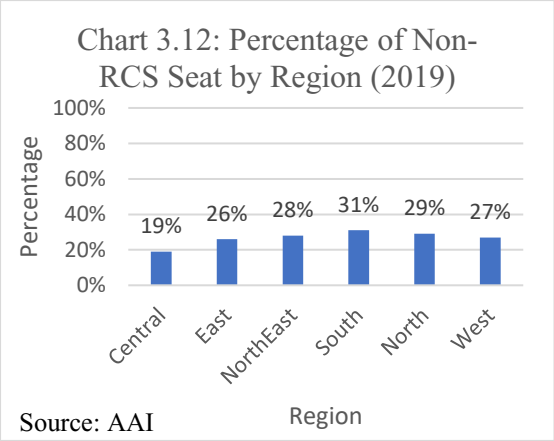
Chart 3.11: Percentage Distribution of RCS Flights by Region (2019)



Source: AAI

[654] Airport Authority of India, Press Release, "List of RCS Routes Commenced Under RCS-UDAN 1.0, 2.0, 3.0, 4.0 & 4.1" (07 October 2022) online: <https://www.aai.aero/sites/default/files/rcs_news_notifications/439_RCS_Routes_Operationalised_as_on_07.10.2022.pdf>
[655] *ICRA Report*, *supra* note 652.
[656] *UDAN Report*, *supra* note 651 at 11-12.
[657] *Ibid* at 14-15.
[658] *RCS 4.0*, *supra*, note 626 at para 3.3.2.1.
[659] *Ibid* at para 1.3.1.6.

However, while comparing regional results of RCS in terms of passengers travelled, one also needs to consider the demographic differences between the regions. The share of the population in the North-eastern region is significantly lower than in other parts of the country.



As mentioned earlier, the RCS is a ten-year scheme, and the guiding principle is to encourage the sustainability of operations such that the connectivity established is not dependent on VGF in perpetuity.[660] Chart 3.12 shows the percentage of non-RCS seats (seats without airfare caps and VGF support). A higher percentage of non-RCS seats on RCS routes indicates higher sustainability and that there is latent demand and supply beyond subsidies. This sustainability would eventually lay down the path for the scheme to be phased out.

3.4.2.3. Recommendations

Even though RCS has boosted traffic to remote parts of the country, it is often argued that subsidies hinder cost reduction and cost efficiency as well as distort competition.[661] However, the system of subsidies is not unique to India. Countries like the US has the Essential Air Service Program in their deregulation act that provides subsidies to carriers to maintain scheduled services to remote parts of the country. But the US experience shows that despite subsidies, services to small communities are still adversely affected.[662] At the same time, the mandatory requirement of the RDG in India to fly on remote routes although ensures connectivity, adds to the financial burden of the carriers and is not sustainable for many airlines which eventually left the market.[663] Therefore, a system of merely providing subsidies or merely mandating flights on remote routes is not the most efficient practice.

The RCS through its unique approach achieves the same objective through the dual mechanism of subsidies (through concessions and VGF) and the mandate to fulfil the minimum performance requirement of the SAO to ensure connectivity. Moreover, caps on airfares make flying affordable to the mass. The scheme upholds the spirit of deregulation as no airline is mandated to fly on these routes. Airlines are selected through a competitive bidding process

[660] *Ibid* at para 1.3.1.6.
[661] K Chandrashekhar Iyer & Nivea Thomas, "A Critical Review on Regional Connectivity Scheme of India" (2020) 48 Elsevier Transportation Research Procedia 47 at 57.
[662] See chapter 1, para 6.4.3, *above.*
[663] See chapter 3, paragraph 2.2, *above.*

and only those airlines that want to fly on these routes submit their bids. Lastly, to address the issue of subsidies, the scheme is designed to be eliminated in a span of ten years. Subsidies are a temporary aid to boost connectivity and would be stopped once the market is sustainable. As mentioned earlier, to boost sustainability on RCS routes by operators, priority is given to those bidders that request no VGF or the lowest VGF. Furthermore, allowing carriers to have non-RCS seats (where fares are determined by market forces) on RCS routes, encourages the carriers to be self-sustainable and also acts as an indicator of sustainability on that particular route. Therefore, while RCS is a much-needed unique scheme, it is recommended that all efforts should be taken to sunset the scheme at the end of its tenure and make regional connectivity affordable and sustainable without the benefits of the scheme.

It is also recommended that RDG should gradually be phased out or should be merged with the RCS. The mandatory requirement to fly on specific routes not only goes against the spirit of deregulation but also unduly adds to the financial misery of carriers who are forced to operate without subsidies especially when RDG and RCS have the same objectives and end goals. It is also unfair that scheduled airlines are mandated to fly on regional routes, but selected airlines are incentivised to fly under the RCS. Therefore, it is suggested that the Category II and III RDG routes be declared RCS routes to ensure continued connectivity. While prior to the launch of the RCS, the RDG was an appropriate instrument, with a more comprehensive instrument like the RCS, it seems unnecessary to have two sets of regulations serving the same purpose.

Another equally important recommendation is that the implementation of the RCS should be used as an opportunity to develop regional airlines in India. This class of airlines never dominated the aviation sector in India but in the US, they are largely responsible for regional connectivity. In fact, regional airlines first developed a substantial presence in the US and then the concept spread elsewhere.[664] They are responsible for carrying around 25% of all US domestic passengers and more than four hundred US communities rely exclusively on regional airline service.[665] Regional airlines have the appropriate fleet size to suit the demand on regional routes and are best suited to develop regional connectivity. Their business model focuses on particular regions of the country and filling the niche markets that the major airlines may overlook. In the US, they often partner with major airlines to fly passengers from their dominant region to the large airline's hub from where they can be transported forward.[666] The

[664] Gerald N Cook & Bruce Billig, *Airline Operations and Management* (London: Routledge, 2017) at 110.
[665] *Ibid* at 108.
[666] *Ibid* at 107.

development of regional airlines can reduce the burden on scheduled airlines which often do not have the appropriate resources to cater to these low-demand routes.

Recently in 2016, India started issuing a new type of licence for scheduled commuter airlines aka regional airlines.[667] It was introduced solely to 'promote/enhance regional connectivity.'[668] These carriers are permitted to operate scheduled operations on routes except Category I routes as per the RDG[669] i.e., their operations are limited to regional routes. They have low fleet and equity entry requirements compared to scheduled airlines. They can commence operations with a minimum of only three aircraft and equity of Rs 50 million if their fleet comprises of aircraft with a maximum take-off mass of up to 5700 kg. The equity requirement increases to Rs 100 million if the fleet comprises of aircraft having a take-off mass of more than 5700 kg.[670] They are also permitted to operate with turbine-powered single-engine aeroplanes with a seating capacity not exceeding nine.

Apart from their mandate of flying scheduled operations on Category II and III routes of the RDG, this new class of airlines has been awarded several routes under the RCS where they fly with incentives.[671] This aid in the initial years of their operations lets them adequately understand the market demand on regional routes without the worry of running into financial difficulties as the VGF ensures that the costs of operations are recovered. At the same time, the unique mechanism of the RCS ensures that they thrive to bring sustainability to their operations. In this light, it is reiterated that the RCS should promote the newly launched scheduled commuter airlines such that after the end of the tenure of the RCS, scheduled commuter airlines with their expertise and appropriate resources should be able to keep the connectivity without any regulation or government aid.

3.4.3. Anticompetitive Behaviour and Airfares

Except for the restrictions on fares under the RCS, fares in the Indian aviation market are not regulated and are open to being determined by market forces. This has resulted in fares ranging from excessively high to very low which might affect the financial viability of the air service providers.

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667 *CAR Section 3 Series C Part XII*, *supra* note 595.
668 *Ibid* at para 1.2.
669 *Ibid* at para 2.
670 *Ibid* at para 3.2.
671 See Airport Authority of India, Press Release, "List of RCS Routes Commenced Under RCS-UDAN 1.0, 2.0, 3.0, & 4.0" (29 November 2022), online: <https://www.aai.aero/sites/default/files/rcs_news_notifications/395-RCS-Routes-Operationalised-as-on-29.11.2021.pdf>

Low prices typically demonstrate an anti-competitive behaviour called predatory pricing wherein a market player would set their prices low, often below their costs to drive out rival competition and in the long term raise the prices to make up for the lost profits.[672] This kind of practice is common in markets where there is not much product differentiation and competition is based on price like in the aviation industry. The objective of predation is to eliminate rivals, and thereafter the firm can recoup its short-term losses by raising the prices. The only problem with this approach is that recoupment might not be possible if a new rival enters the market after the eradication of the incumbent rival.[673] However, with high regulatory and naturally high entry barriers in India, the possibility of entry of a new carrier remains low and therefore in the Indian aviation market, predatory pricing works best to eliminate competition. Predatory pricing is not merely a theoretical concept that might potentially affect competition in the Indian airline business. It is a common phenomenon making the market anti-competitive and affecting airfares. As per a report by the Economic Times published in January 2020, India's then aviation minister said, 'some predatory pricing is taking place in airfares and the government is concerned that if this continues, more airlines will shut down.'[674] Predatory pricing is illegal under the Indian Competition Act 2002 and no enterprise is allowed to abuse its dominant position in the market by indulging in predatory pricing.[675] An enterprise is said to have indulged in predatory pricing if it sets its prices below its costs with the intention of driving out competition with the plan to recover the losses at a later stage.[676] This case, however, was not probed likely due to the lack of evidence of misuse of the dominant position.

Exactly on the other end of the spectrum, the Indian aviation industry has witnessed high airfares due to potential cartel behaviour. Even in this case, high entry barriers protect the functioning of a cartel. There have been complaints of similar fares on certain routes *viz* Delhi-Bombay-Delhi, Delhi-Bangalore-Delhi, Delhi-Hyderabad-Delhi, and Delhi-Pune-Delhi by major scheduled operators IndiGo, SpiceJet, GoAir, State-run Air India and now-defunct Jet Airways. A probe into the matter was ordered under the Competition Act 2002 upon a letter of the Lok Sabha (Lower House of the National Assembly) Secretariat with a request to examine

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[672] George A Hay, "Predatory Pricing" (1990) 58:4 Antitrust LJ 913 at 914.
[673] Harry S Gerla, "The Psychology of Predatory Pricing: Why Predatory Pricing Pays" (1985) 39:3 Sw LJ 755 at 756
[674] "Predatory Airfare Pricing Going on, Airlines will Shut Down if it Continues: Aviation Minister Hardeep Singh Puri", *The Economic Times* (01 January 2020), online: <https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/predatory-airfare-pricing-going-on-airlines-will-shut-down-if-it-continues-aviation-minister-hardeep-singh-puri/articleshow/73054750.cms>
[675] *Competition Act* 2002, *supra* note 45, s 4(2)(a)(ii).
[676] *Transparent Energy Systems (P) Ltd. v TECPRO Systems Ltd*., [2013] Competition Commission of India Case No. 09 of 2013 (India).

whether there is any evidence of cartelisation in the airline sector.[677] The Act prohibits any agreement or decision that is likely to cause an appreciable adverse effect on competition within India. These include agreements that directly or indirectly determine prices and such agreements are void.[678] The act also penalises parallel conduct if the conduct can be attributed to information exchanged between competitors and not done independently according to market conditions. After enquiry in this case no evidence suggestive of a meeting of minds and no contravention of the Competition Act was found.[679]

These instances highlight the possibility of cartelisation as well as predation and a need for stronger surveillance of anti-competitive practices within the industry. Cartelisation and predation both significantly affect airfares and entry into the airline industry. Cartels erect entry barriers and predation makes it unprofitable for new entrants. In both cases, competition is affected, and the long-term viability of the industry comes at stake. The current market status with only a few players and with two entities – Tata Industries (controlling Air India, Air Vistara and AirAsia India) and IndiGo – handling almost 80% of India's domestic traffic calls for attention.[680] The Herfindahl Hirschman Index (HHI) is an indicator used to assess the amount of competition among firms in the industry. Any increase in the index indicates market concentration and a decrease in competition and vice versa.[681] The HII in the aviation industry in India has risen to an all-time high of around 3,500 in 2021[682] from about 2,300 in 2018 and 1611 in 2011,[683] indicating a decrease in competition and an increase in market power. Under these circumstances, it is recommended that entry barriers must be reduced thereby promoting a larger number of competitors. An increased number of competitors reduces the possibility of cartel behaviour as well as predation.

It is also recommended that the regulator must take concrete steps to monitor and track anti-competitive behaviour in the Indian airline industry. A look at the US antitrust laws reveals that both the Department of Transportation and Justice are responsible for overseeing anticompetitive practices in the airline industry, though their oversights differ in scope. While

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[677] *In Re., Alleged Cartelization in the Airlines Industry*, [2021] 2021 SCC OnLine CCI 3 (India).
[678] *Competition Act*, *supra* note 45, s 3(1) read with 3(3).
[679] *In Re., Alleged Cartelization in the Airlines Industry*, *supra* note 677.
[680] *DGCA Handbook 2021*, *supra* note 596 at 9.
[681] The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. The agencies generally consider markets in which the HHI is between 1,500 and 2,500 points to be moderately concentrated and consider markets in which the HHI is in excess of 2,500 points to be highly concentrated; See "Herfindahl–Hirschman Index" (31 July 2018), online: *Department of Justice* <https://www.justice.gov/atr/herfindahl-hirschman-index>
[682] Krishna Kant, "After Air India Privatisation, Aviation Set To Be 2nd Most Concentrated Mkt", *Business Standard* (14 October 2021), online: <https://www.business-standard.com/article/companies/after-air-india-privatisation-aviation-set-to-be-2nd-most-concentrated-mkt-121101200045_1.html>
[683] *Report of Working Group 2012*, *supra* note 518 at para 8.1.7.5.

the Department of Justice looks over mergers and acquisitions, DOT oversees unfair and deceptive trade practices within the industry.[684] This is because the DOT is broadly responsible for regulating air travel and therefore is best suited to enforce the antitrust laws in the airline industry.[685] Whereas in India, the Competition Commission of India (CCI) enforces anti-competition laws across all industries. But due to the nuanced nature of the airline industry, and inspired by the US regulations, it is recommended that DGCA and CCI must work together in putting into place a monitoring mechanism for airline pricing in India. CCI does not necessarily have the expertise and resources to regulate competition in the airline industry whereas DGCA has all the required data and information pertaining to airline operations and pricing and therefore a hand-in-hand approach of DGCA and CCI is recommended for maintaining effective competition which would in turn ensure airfares are truly determined by competitiveness and market forces.

3.4.4. Other Policies Affecting Competition

Airport slot allocation policy is another regulation that affects competitiveness and limits the entry of new entrants. Slot allocation is regulated by the 'Guidelines for Slot Allocation (Revised 2013)'. According to this policy, India like most countries uses the historicity rule also called the grandfather rule. Under this rule, an airline can retain a series of slots allocated to it in the previous session if the airline can demonstrate to the satisfaction of the slot coordinator that the series of slots were operated 80% of the time during the period allocated.[686] The historic baseline date of 31st January (summer) and 31st August (winter) is used as the basis for determining eligibility for historic precedence.[687] When allocating slots among airlines, the first priority is given to historic slots. Second, on the priority list are changes to a historic slot by an airline over new requests for the same slot.[688] Once historic slots and changes to historic slots are allocated, the slot coordinator creates a pool including newly created slots which are allocated to airlines. 50% of the slots contained in the pool must go to new entrants unless requests by new entrants are less than 50%.[689] Slots are allocated twice each year.[690]

The problem with this grandfather rule of slot allocation is that it creates a barrier to entry for new carriers as they limit their ability to compete for attractive slots. Slots that are utilised up

[684] See chapter 1, para 6.3.3, *above.*
[685] Jonathan Edelman, "Reviving Antitrust Enforcement in the Airline Industry" (2021) 120 Mich L Rev 125 at 130.
[686] India, Ministry of Civil Aviation, *Guidelines For Slot Allocation* (Revised 2013) at para VI (1).
[687] *Ibid* at para VI(2)(i)(a).
[688] *Ibid* at para VII (15).
[689] *Ibid* at para VII (16)(i).
[690] *Ibid* at para VII (4).

to 80% or more are usually those slots that tend to bring higher revenue. New entrants are unable to compete on lucrative routes due to the unavailability of slots. Moreover, underutilised slots only free up after six months. These are typically those that are at odd hours not generating higher revenues. Furthermore, in cases of mergers or acquisitions amongst incumbent carriers, all the pre-merger slots of both the merging companies are allotted to the newly merged carrier.[691] Under this current system, unless an airline exits the market, they can potentially retain all high revenue slots simply by utilising it up to 80%. A report by CAPA also points out that the current slot allocation systems at Indian airports are not aligned with global best practices.[692] This is because India does not allow secondary trading of slots, which airlines could have monetised either due to non-usage or during bankruptcies.[693] Countries like the UK, US and EU allow slot trading for financial incentives.[694] CAPA estimated that 'Jet Airways' portfolio of peak international and domestic slots at CSMIA [Mumbai airport] would have been valued at [USD] 300-315 million in 2019' which could have triggered an influx of cash.'[695] As a solution to this problem, the Ministry of Civil Aviation is considering a proposal to reallocate slots to airlines every two months instead of twice a year.[696] A more frequent review is expected to ensure improvement in airport utilisation but the problem with the grandfather clause remains.

Another important factor affecting aviation in India is the cost of Aviation Turbine Fuel (ATF) which accounts for 40-50% of an airline's operating costs.[697] ATF in India is subject to central excise duty of 11%[698] and Value Added Tax (VAT). VAT charged by states ranges from 1-30%. At the time of writing this paper, sixteen states had reduced VAT to 1-4% but eight states still charge a VAT of 20-30% which includes the states housing the country's busiest airports of Delhi, Mumbai, Chennai, and Kolkata.[699] Along with these heavy taxes, due to the global fuel crisis, ATF prices have been on a hike in recent years. The industry experienced more than

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[691] *Report of Working Group 2012*, *supra* note 518 at para 8.1.7.9.3.
[692] "Airport Slot Reform: What are the Regulatory and Competitive Barriers and Drivers?" (November 2021), online: *CAPA* <https://centreforaviation.com/analysis/video/airport-slot-reform-what-are-the-regulatory-and-competitive-barriers-and-drivers-1615>
[693] *Report of Working Group 2012*, *supra* note 518 at para 8.1.7.10.1.
[694] *Ibid.*
[695] Rhik Kundu, "Slot Allocation In India Needs Regulation, Transparency: CAPA India", *Live Mint* (15 July 2021), online: <https://www.livemint.com/companies/news/slot-allocation-in-india-need-regulation-transparency-capa-india-11626360070299.html>
[696] Anu Sharma, "Airlines with Poor Slot Utilization may Lose Them Sooner", *Live Mint* (09 October 2020), online: <https://www.livemint.com/companies/news/airlines-with-poor-slot-utilization-may-lose-them-sooner-11665334898416.html>
[697] *Report of Working Group 2012*, *supra* note 518 at para 12.1.19.
[698] India, Central Board of Indirect Taxes and Customs, *Central Excise Tariff 2017-18* at chapter 27.
[699] "Scindia Asks States to Lower VAT on Aviation Fuel", *Financial Express* (03 September 2022), online: <https://www.financialexpress.com/market/commodities/scindia-asks-states-to-lower-vat-on-aviation-fuel/2653757/>

120% hike in ATF since June 2021.[700] Notwithstanding the increase in global fuel prices, the cost of ATF is higher in India due to heavy central and state taxes. The following chart compares the price of jet fuel in the major Indian cities with the rest of the world.

Chart 3.13 – Jet Fuel Price in Different Regions of the World v Major Indian Cities (2022)

World		**India**	
Regions	**USD/Barrel** (October 2022)	**Major Cities**	**USD/Barrel** (October 2022)
Asia & Oceania	128.28	Delhi	220.39
Europe	143.81	Kolkata	232.81
North America	155.09	Mumbai	218.24
Middle East and Africa	132.05	Chennai	228.75

*Data on Jet Fuel Prices around the world obtained from IATA Jet Fuel Monitor (USD/Barrel)[701]

*Data on Jet Fuel Prices in Indian cities obtained from Indian Oil Corporation Limited (Rs/KL)[702]

* Conversion – 1 KL = 6.29 Barrel[703]

* Conversion – Rs 1 = USD 0.012 (conversion rate as on 28 October 2022)

ATF prices in India are unduly higher than international benchmarks resulting in a tremendous financial burden on Indian carriers. The high price of fuel not only deters the entry of new carriers but also the financial viability of the incumbents. This also results in higher airfares and in the year 2022, ticket prices on popular routes are up by 50-75% compared to last year.[704] It is the need of the hour for the regulator and the government to reassess taxation on ATF and take concrete steps to reduce the prices.

Another factor affecting competition is the rule on exemption which permits the DGCA to grant exemptions to any aircraft or class of aircraft or any person or class of persons from the compliance of direction(s) given in CAR under Rule 133A (4) of the Aircraft Rules, 1937. The CARs do not provide any guidance on the grounds for seeking exemption expect merely stating that exemptions can be granted due to 'exceptional circumstances, physical constraints, non-availability of specified equipment etc.'[705] This leaves enormous room for discretion and no

[700] "ATF Prices Rise 9% in a Month, Over 80% in 1 Year", *Hindustan Times* (04 October 2021), online: <https://www.hindustantimes.com/business/atf-prices-rise-9-in-a-month-over-80-in-1-year-101633305414052.html>

[701] "Jet Fuel Price Monitor" (14 October 2022), online: *IATA* <https://www.iata.org/en/publications/economics/fuel-monitor/>

[702] "Aviation Fuel" (01 October 2022), online: *Indian Oil Corporations Limited* <https://iocl.com/aviation-fuel>

[703] "Sustainable Aviation Fuel Metrics" (February 2021), online (pdf): *Aviation Benefits Beyond Borders* <https://aviationbenefits.org/media/167233/fact-sheet_13_saf-metrics-and-conversions_4.pdf>

[704] "ATF Prices at All-Time High: Flight Tickets to Cost you More. What Spicejet CMD Says on Increase in Airfares", *Live Mint* (16 June 2022), online: <https://www.livemint.com/news/india/atf-prices-at-all-time-high-how-jet-fuel-hike-will-impact-air-travel-11655352605420.html>

[705] India, DGCA, *Civil Aviation Requirement Section 1 – General Series B Part III - Procedure for Seeking Exemption from Civil Aviation Requirements,* F. No. 9/11/2017-IR (2017) at para 1.

guidance on how to use the discretionary power. While this has not yet caused any apparent impact on competition, misuse of this discretion can lead to potential preferential treatment.

4. International Liberalisation

This chapter till now has primarily focused on domestic liberalisation in India. It would be wrong to assume that liberalisation was limited only to the domestic market. Unlike the US, which simultaneously deregulated both the international and domestic aviation markets, India liberalised the international sector much later and at a much slower pace. As discussed in the first chapter, international liberalisation heavily relies on ASAs with other countries along with the countries' internal policies that dictate the pace of liberalisation of the ASAs that are negotiated with their counterparts. As will be seen from the following discussion, India's internal policies inhibit complete liberalisation, but a gradual approach to liberalisation has already commenced. This section involves a look at India's historical approaches and a critical review of the current approaches.

4.1. A Look at the Early Years

Increasing international air transport liberalisation in the 1980s, which started with the US and spread to other western countries, confronted most developing countries with enormous challenges of adjustment and adaptation. However, the system of bilateralism which reinforces absolute sovereignty over the State's airspace provided 'a normative umbrella under which the Third World countries could, in theory, protect and advance its interests based on fair and equal opportunity.'[706] Developing countries preferred the regime of bilateralism which allowed them to overcome their inherent vulnerabilities through the authority-based allocation of international air traffic rights with other States.[707] India was at the forefront of the restrictive regime of bilateralism and it made its position clear at the ICAO. In 1992, India's delegate to ICAO argued that bilateralism had served the industry well and this regime should continue.[708] India in another speech at the ICAO warned against 'discernible attempt on the part of certain powerful foreign carriers to monopolise the airspace'.[709] India's position found support among other developing countries which reflected the notion of protectionism of their flag carriers from adverse competition from powerful foreign carriers.

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[706] Nayar, *supra* note 28 at 1.
[707] Stephen D Kranser, *Structural Conflict: The Third World Against Global Liberalism* (Berkley: University of California Press, 1985) at 196-97.
[708] ICAO, *World-wide Air Transport Colloquium, Montreal, 6-10 April 1992: Exploring the Future of International Air Transport Regulation – Proceedings* (Montreal: ICAO, 1992).
[709] Nayar, *supra* note 28 at 2.

With this endorsement and adherence to bilateralism, India adopted a system of restrictive reciprocity with foreign governments and their carriers. Capacity, routes, fares and designations were regulated. In most cases, the capacity of Indian and foreign carriers was predetermined, pricing was regulated through a single disapproval mechanism and routes that could be served were named in the ASAs.[710] Internally, India monopolised international air transportation since nationalisation in 1952. Primarily Air India and in the later years Indian Airlines, both being government carriers, were granted exclusive rights to fly on international routes.[711] Even with domestic deregulation in the 1990s, international routes were beyond the access of private carriers and the regulated regime continued till the early 21st century.

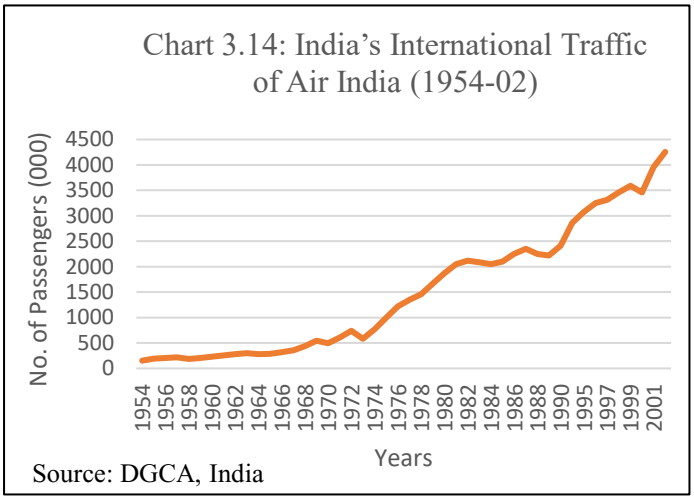
4.2. Performance and Market Position of Indian Carriers prior to Liberalisation

While it is true that India allowed access only to the national carriers to cater to the international market, it would be incorrect to say that the Indian carriers enjoyed a monopoly. Even though capacity and fares were regulated through ASAs, the carriers faced some competition from foreign carriers. Therefore, the important issue that arises is how the national carriers performed in obtaining their rightful share in the country's international traffic. This paper limits itself to three important parameters – profitability, passenger traffic and market share in the evaluation of the performance.

With respect to the first criterion – profitability - Air India stands out. Unlike Indian Airlines which even with its monopoly in the domestic market generated huge losses, Air India was overall profitable. Over the period when Air India was the only carrier granted access to international routes (1960-2003), it remained profitable for most of the time. Up to the 1970s, Air India made small but steady profits. Even though the airline did incur some losses between 1970-74 and 1995-00, it was followed by recovery in the following years.[712] What is even more remarkable was the profits generated in the years 1990 and 1992. With a profit of Rs 2,895.9 million, Air India was ranked sixth in the world in terms of profitability in 1992.[713] This came at a time when the global airline industry was in severe economic crisis with the IATA member airlines losing a total of USD 11.5 billion in this period between 1990 to 1992. Out of these 11.5 billion losses, US carriers' share accounted for almost USD 1 billion.[714] Prof. Paul Dempsey attributed the major cause of the losses of US airlines to deregulation. He wrote that

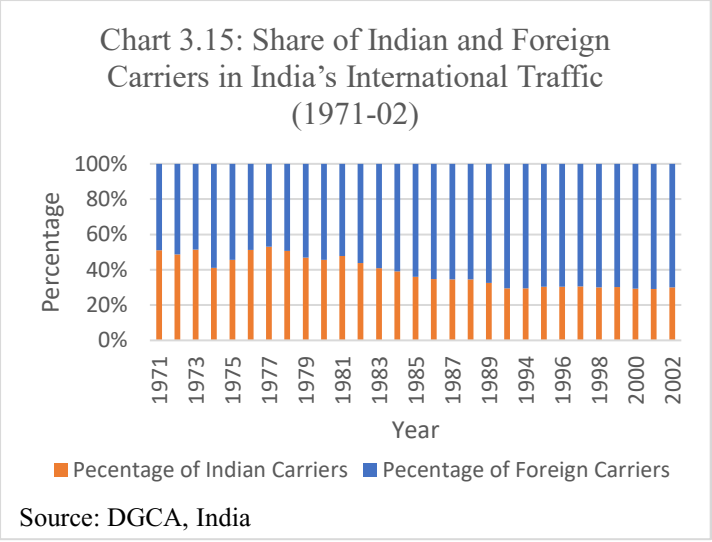
[710] See India, DGCA, *Bilateral Air Service Agreements* (New Delhi).
[711] See chapter 2, para 3.2, *above*.
[712] See chapter 2, chart 2.2, *above.*
[713] Nayar, *supra* note 28 at 6.
[714] Paul S Dempsey, "The Financial Performance of the Airline Industry Post-Deregulation" (2008) Hous L Rev 421 at 425.

'the fundamental problem is excess capacity relative to demand and excess cost relative to price. Too often, there are an insufficient number of passengers willing to pay a price sufficient to cover the industry's cost' all of which has happened since deregulation.[715] On the other hand, Air India continued to generate profits within the ambit of regulations. What was even striking about the profits was that Air India generated resources from within as it purchased aircraft and expanded its operations rather than depending on the government.[716]



Regarding the second criterion – passenger traffic - Indian carriers have seen a vast expansion in their international scheduled passenger traffic. Between 1954 and 2002, total international traffic carried by Indian carriers grew from 0.14 million to almost 4.5 million. Graph 3.14 shows the steady increase of scheduled international air traffic of Air India during the period when only the national carriers flew on international routes.

However, the absolute number of passengers does not portray a complete picture of the performance of the government carriers. Therefore, the real question that arises is the share of Indian carriers in India's international traffic. As mentioned earlier, based on the principle of reciprocity arising out of bilateralism, foreign carriers also have a share in the passengers flying to and from India. Chart 3.15 shows the share of Indian and foreign carriers in terms of international passengers carried between 1971 and 2002. Data on this aspect is not directly and readily available and is compiled from a combination of sources. As seen from the chart, between 1971 to 1978, there were some fluctuations in the share of



[715] *Ibid* at 437.
[716] Nayar, *supra* note 28 at 7.

traffic carried by Indian carriers. In certain years Indian carriers' share dropped to 45% but rebounded near the 50% mark in the following year. This trend changed from 1980 onwards. There had been a consistent, continuous, and uninterrupted slide in the share of Indian carriers. The trend of diminishing market share continued till the end of the 1990s and the Indian carriers' combined market share of India's international traffic stood at 28% in 2004 and 31% in 2005. The conclusion is compelling that foreign carriers, which had less than half of India's market in 1971, had by 1990 taken more than 70%, notwithstanding the bilateral regime of reciprocity that guaranteed an equal share of capacity. This trend continued till 2005 with foreign carriers ferrying almost 70% of India's international traffic. Despite the growth in the absolute number of international travellers, the government carriers' share continued to decline as it failed to cope with the traffic demand which was attributed to constrained fleet size and capacity.[717] Foreign carriers took advantage of the national carriers' inability to cater to the growing demand for international traffic to expand their operations in India.

By the 1990s the share of government carriers in international traffic was less than 30% primarily due to capacity constraints. At the same time, the government liberalised the domestic aviation sector and allowed private participation to cope with the capacity constraints in the domestic market. This begs the question if liberalisation could happen in the domestic market to solve the issue of capacity, why were the private players not entitled to fly on international routes which suffered from the same issue of capacity constraints, especially when there was precedence of the US simultaneously liberalising the domestic and international markets? The answer to this question lies in the notion of flag carriers.

4.3. The Notion of Flag Carriers

Prior to 2003, India had adopted a protectionist policy towards its flag carriers instead of leveraging air connectivity to serve the larger interest of providing competitive and quality service that boosts the economy. At the centre of the policy were India's flag carriers – Air India and Indian Airlines.

The term flag carrier *usually* refers to an airline which is either wholly or partially owned by the respective State and represents the national identity of the State concerned.[718] The term *usually* has been deliberately used as there are some exceptions. For example, the US does not have an airline that is wholly or partly owned by the government, rather a flag carrier in the US

[717] Mazumdar, *supra* note 450 at 34.
[718] Evan Jackson, *The Anthropology of Airlines: Flag Carriers, Nationalism, Place, and Identity* (Thesis in Bachelor of Arts in Liberal Arts, Florida Atlantic University, 2015) at 2.

is the one holding the State's registration mark.[719] A flag carrier is defined 'as an entity which helps to promote a national consciousness, serving to socially integrate many different communities into a cohesive region creating an awareness of their national identity.'[720] Most states, with the US being a notable exception, have experimented with a State-owned airline at some point in history.[721]

The approach to protectionism arises from this representation of national identity by the flag carriers. States attach prestige to them and attempt to limit competition from mega-airlines to keep the flag carriers aloft.[722] In this attempt to limit competition, flag carriers are granted a monopoly to the greatest extent possible. On the international front, countries negotiate strict bilateral ASAs with predetermined capacity and on the domestic front, private carriers are given no to limited access to international routes. The situation in India prior to 2003 was no different. Therefore, irrespective of the diminishing market share of Air India in India's foreign market share, the government continued to favour Air India and blocked access to all other private carriers.

The poor performance of India's flag carrier is nothing unique. Flag carriers around the world with a few exceptions have turned out to be inefficient and loss-making enterprises, relying on government resources to sustain themselves. Several flag carriers around the world had to shut down operations due to their deteriorating performances. Some notable ones are Swissair (2002), Sabena (2001), Armenian Airlines (2003), Slovak Airlines (2007), FlyLAL of Lithuania (2009), Malev (2012), Cyprus Airways (2015), Estonian Air (2015), Bir Bosna (2015) and Adria Airways of Slovenia.[723] Others realised the futility of maintaining a flag carrier and the government disinvested in them. British Airways and Japan Airlines were divested 100% whereas, in Air France and KLM, the government retained only a minority stake.[724] On the other hand, notwithstanding the red flags, Air India and Indian Airlines not only continued to remain wholly owned by the government but also remained the only international carriers till 2003. It is worth mentioning that some flag carriers like Singapore Airlines, Emirates, and Qatar Airways have remained profitable and top-performing carriers but what distinguishes them from the unsuccessful ones are the deep pockets and the ability

[719] US, FAA, *Federal Aviation Regulations* FAR 47.401.
[720] K Raguraman, "Airlines as Instruments for Nation Building and National Identity: Case Study of Malaysia And Singapore" (1997) 5:4 Elsevier J Transport Geography 239 at 240.
[721] Ashley Taborda, "The Exchange of Air Traffic Rights: A System Highly Flawed, Yet Seemingly Indestructible" (2016) 41 Ann Air & Sp L 33 at 47.
[722] *Ibid* at 64.
[723] R Singh, *supra* note 32 at 311.
[724] *Ibid* at 312.

and interests of the respective States to substantially invest in the flag carriers.[725] Barring a few exceptions, the general trend has been that of poor performance by flag carriers around the world. Aviation specialist John Strickland explained that[726]

> The best examples of success is where countries have recognised it is not always in their own interest to retain a flag carrier, contrary to their emotional feeling, and so, to protect the carrier, have let commercial management make the best decisions.

India eventually came to terms with the fact that the notion of a flag carrier and the emotion attached should make way for a more practical and realistic business model that would benefit the aviation industry and the economy at large. Starting in 2003, private carriers were allowed to fly on international routes, but several conditions were attached. Air India remained the flag carrier and continued to enjoy privileges at the competitive disadvantage of others.

4.4. Liberalisation of International Air Transportation

India embarked on the path of liberalisation of international air transportation from 2003 onwards. This change in policy was in accordance with the recommendations of the 'Naresh Chandra Committee Report' which taking into consideration several factors *viz* the minuscule share of India in the world aviation traffic and the declining share of Indian carriers suggested that:[727]

> India should actively pursue the objective of complete liberalisation of the international air transport segment through (a) seeking more liberal arrangements under the bilaterals; and (b) enhancing full access to wider market segments by joining a regional or a plurilateral group of countries with a similar agenda of liberalisation.

Based on the recommendations, India took a slew of measures to liberalise international air transportation. The first move was to liberalise the market access regime with the Association of Southeast Asian Nations (ASEAN) countries and unlimited market access was given to eighteen tourist gateways in India.[728] In 2005, India signed an open skies agreement with the US which provides for no restriction on capacity, routing, or pricing.[729] The ASA with the UK

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[725] See chapter 1, para 7.3.1, *above.*
[726] Hugh Morris & Oliver Smith, "With Another National Airline on the Brink, Are We Seeing the Slow Death of the Flag Carrier", *The Telegraph* (26 September 2019), online: <https://www.telegraph.co.uk/travel/travel-truths/flag-carriers-death-of-legacy-airlines-air-france/>
[727] *Naresh Chandra Committee Report*, *supra* note 579 at para 3.3.4.
[728] See ASAs with ASEAN Countries in *Bilateral Air Service Agreements*, *supra* note 710.
[729] *Air Transport Agreement Between the Government of the United States of America and the Government of India* 14 April 2015, (entered into force 21 June 2005) [*India-US Open Skies Agreement*].

was also significantly liberalised in 2004[730] which now allows for multiple designations, multiple entry points (international origin and destination airports), and fifth freedom rights.[731] Moreover, the ASA with the UK includes a free pricing clause whereby carriers are free to set prices without interference from the respective States but capacity is predetermined.[732] With the US, on the other hand, there is no restriction on capacity but the provision on pricing includes a method of double disapproval i.e., neither State can take unilateral action to stop proposed pricing by the carrier, and both the State parties through consultation needs to enter upon an agreement before interfering with pricing.[733] That said, the ASAs of India with most other countries are restrictive in nature with fixed capacity, predetermined authorised arrival and departure points, and the pricing clause includes a provision of single disapproval where either State can disapprove the price set by a carrier without consulting the other State.[734] On the scale of restrictiveness, the single disapproval method of pricing is considered the most restrictive followed by double disapproval and the most liberal being free pricing.

India also allowed its private carriers to operate international services from 2003 onwards and accordingly adopted a policy to liberalise the ASAs wherein multiple designations were allowed. However, not all private airlines were allowed to fly on international routes. The government adopted the 5/20 rule in 2005 wherein only those carriers that had five years of operational experience in the domestic market and at least twenty aircraft in their fleet were allowed to fly internationally.[735] This rule significantly impacted competition on international routes. The fleet and experience requirements deterred the entry of carriers and reduced the choice of customers. Moreover, this rule came at a time when only Jet Airways and Sahara Airlines would qualify under this rule to commence international operations. As a result, this did not solve the issue of capacity shortage which was the primary reason for liberalising international air transportation. Between 2005 when this rule came into force and 2010, capacity entitlement on international routes was raised by four times, but Indian carriers including the private carriers approved to fly internationally were unable to take advantage of the enhanced capacity entitlement due to a lack of enough aircraft.[736] The 5/20 rule which limited Indian carriers to flying internationally favoured the foreign carriers of those countries

[730] See ASA with United Kingdom in *Bilateral Air Service Agreements*, *supra* note 710.
[731] See appendix, *below.*
[732] See ASA with United Kingdom in *Bilateral Air Service Agreements*, *supra* note 710.
[733] *India-US Open Skies Agreement*, *supra* note 729, art 11 & 12.
[734] See, *Bilateral Air Service Agreements*, *supra* note 710.
[735] India, DGCA, *Guidelines for Operation of Indian Scheduled Carriers on International Routes*, Aeronautical Information Circulars 2/2005, (21 January 2005) [superseded].
[736] P R Sanjai, "India to Talk to 40 Countries on Bilateral Air Service Pacts", *Live Mint* (07 October 2011), online: <http://www.livemint.com/2011/10/07000747/India-to-talk-to-40-countries.html>

with which India allowed multiple designations, especially the US carriers with whom India had an open skies agreement. The open skies policy allowed any number of foreign carriers to fly to India without any fleet, equity or experience requirements while putting new Indian domestic carriers at a disadvantage.

An interesting fact about this rule is that it was lobbied for by the industry. According to industry insiders, this rule was brought at the behest of Jet Airways, the oldest private carrier that had survived till that period, to limit competition from other newly established carriers on international routes.[737] With passing years, as more and more incumbent private players became eligible to operate internationally, the aviation ministry faced aggressive opposition to the elimination of the rule by airlines like Jet Airways, IndiGo, SpiceJet and GoAir to prevent new entrants like Air Vistara and AirAsia India from competing on international routes.

Along with the 5/20 rule which distorted competition by allowing only a few private airlines to fly internationally, the government's policy of protecting its flag carrier - Air India - further unlevelled the playing field. Air India, by virtue of being the government carrier, received preference in India's international traffic allotment and the operational plan submitted by the national carrier was considered before the allocation of traffic rights to other eligible applicants.[738] Therefore, even though a few private airlines had the required equity, fleet and experience, they did not get to compete with Air India for traffic rights. Consequently, Air India, despite suffering from poor capacity, would bid for the lucrative routes and would get an unfair competitive advantage over others.

By allowing private carriers to fly internationally and liberalising some ASAs, India embarked on the path of liberalisation, but the extent of liberalisation was not as much as the US. These measures, though limited in nature, paid off. India's traffic grew from 11 million in 1998 to 13.2 million in 2003 and then trebled to more than 35 million in 2010.[739]

4.5. NCAP 2016 – A Step Towards Further Liberalisation

The NCAP 2016 consists of several measures aimed at further liberalising international air transportation. As mentioned earlier, international liberalisation depends on two aspects – a State's internal policy and the bilaterally negotiated ASAs. The policy addresses both aspects

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[737] *Ibid.*
[738] India, DGCA, *Guidelines for Grant of Permission to Indian Air Transport Undertakings for Operation of Scheduled International Air Transport Services* Aeronautical Information Circulars No. 08 of 2009 (10 July 2009), s 3.6. [superseded].
[739] See chapter 3, chart 3.16, *below.*

of international air transport liberalisation. With respect to India's internal policy, the NCAP scrapped the uncompetitive 5/20 rule and replaced it with the 0/20 rule. According to this new rule, a carrier will not require any domestic experience before flying internationally and all new and existing carriers can fly on international routes. However, the airline needs to deploy at least twenty aircraft or 20% of its total capacity (in terms of the average number of seats on all departures put together), whichever is higher for domestic operations.[740] Therefore, a carrier which has less than five years of experience and/or less than twenty aircraft in its fleet can now commence international operations.

Regarding the liberalisation of the ASAs, the government committed to liberalising the regime of bilateral agreements to provide greater ease of doing business and wider choices for passengers.[741] Accordingly, India would negotiate open skies type ASAs on a reciprocal basis with SAARC countries and with countries located entirely beyond a 5000 km radius of New Delhi. Until such open skies agreements are concluded, unlimited flights to and from *major* international airports would be allowed above the existing bilateral rights from these qualifying countries. With respect to airports that do not qualify as *major* airports, international flights would continue as per the existing ASA till they are renegotiated.[742] According to the new policy, so far open skies agreements have been offered to fifty-four countries and formalised with ten countries – Greece, Serbia, Czech Republic, Guyana, Finland, Spain, Sri Lanka, Jamaica and most recently with Canada.[743] Furthermore, for countries that lie partly or fully within the 5000 km radius and where the Indian designated carriers have not utilised 80% of their capacity entitlement but the foreign carriers have utilised their bilateral capacity rights and want an increase in capacity, a committee would be formed to recommend allotment of additional capacity to the foreign carriers.[744] For countries where the Indian designated carriers have utilised more than 80% of their capacity entitlement and desire additional capacity allotment, the ASA would be renegotiated in a usual manner.[745]

Another important step taken towards liberalisation by the NCAP is code-share agreements. Indian carriers are now free to enter into domestic code-share agreements with any foreign carrier to any point in India as per the provisions of the respective ASAs.[746] The policy also

[740] *NCAP*, *supra* note 44 at para 8.
[741] *Ibid* at para 9(a).
[742] *Ibid* at para 9(b).
[743] *Annual Report 2016-17*, *supra* note 37 at para 1.10.
[744] *NCAP*, *supra* note 44 at para 9(c).
[745] *Ibid* at para 9(d).
[746] *Ibid* at para 10(b).

commits to liberalise international code-share agreements between Indian designated carriers and foreign carriers as per the ASAs and prior approval of the Ministry of Civil Aviation would no longer be required. However, such agreements would need to abide by the code-share agreement clause of the respective ASAs and the Indian carriers would merely need to inform the Ministry thirty days prior to the commencement of the first code-share flight.[747]

4.6. Liberalisation beyond the Scope of NCAP

In the year following the release of the NCAP, the Ministry of Commerce and Industry released the 'Consolidated FDI Policy 2017'. In a unique liberalisation move that even most countries with extremely liberal aviation policies have not adopted, the government allowed 100% foreign investment in scheduled and non-scheduled airlines, with an exception to investment by foreign airlines, which is limited to 49% and would require the government's approval. For FDI by foreign non-airline entities in scheduled Indian airlines beyond 49%, approval of the government would be required.[748] With the liberalised FDI policy, the government would grant a permit to a scheduled operator only if:[749]

a) the company is registered and has its principal place of business within India;

b) the chairman and at least two-thirds of the directors are citizens of India; and

c) substantial ownership and effective control are vested in Indian nationals.

Lastly, with the privatisation of Air India in 2022, the concept of a flag carrier ceased to exist and so did Air India's preferential access to India's international traffic rights. Under the new circular adopted on 19 April 2022, the government modified the guidelines for the grant of permission to Indian carriers to operate scheduled international flights. Air India would no longer be given prior consideration. Any Indian carrier meeting the eligibility criteria of having a valid AOP and meeting the 0/20 rule can apply for the allocation of capacity and traffic rights.[750] The government has adopted the following policy for the grant of traffic rights without any discrimination:[751]

> The Ministry of Civil Aviation will examine the applications received from the angle of eligibility and preparedness/capability and consult all eligible airlines before making

[747] *Ibid* at para 10(c).
[748] India, Ministry of Commerce and Industry, *Consolidated FDI Policy* (New Delhi: 2017) at para 5.2.9.2.
[749] *Ibid* at para 5.2.9.3 (c)(iv).
[750] India, DGCA, *Guidelines for the Grant of Permission to Indian Air Transport Undertakings for Operation of Scheduled International Air Transport Services* Aeronautical Information Circulars 10/2022, (19 April 2022) at para 2 and 3.1.
[751] *Ibid* at 3.2.

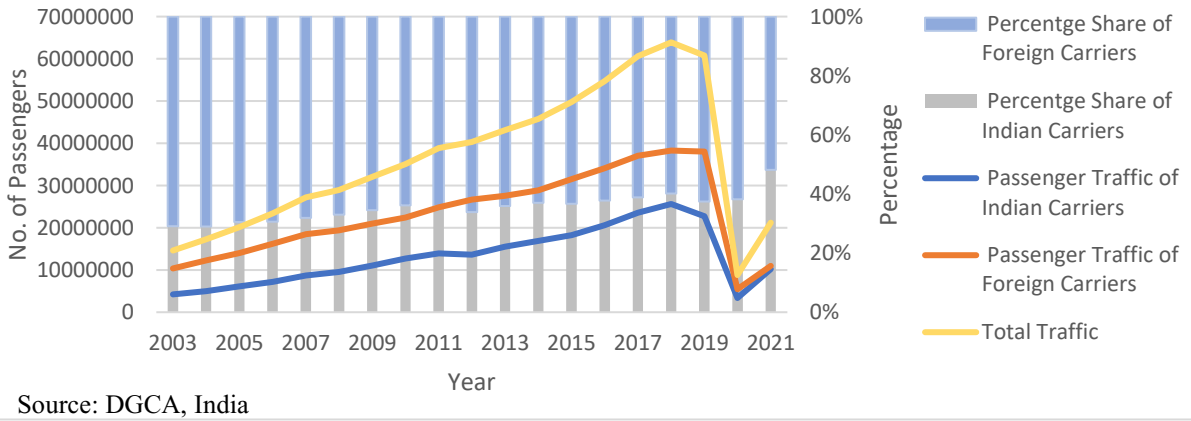
any allocation of traffic rights. On completion of this exercise, the Ministry will allocate traffic rights to the applicant/s taking into account the availability of such rights under the respective bilateral air services agreement. In case the available traffic rights are not sufficient to cover the requirements reflected in the applications, the allocation shall be first made to satisfy the requirement contained in any application for operations from a non-metro airport and the balance traffic rights shall be allocated in the ratio of Available Seat Kilometres (ASK) deployed by the applicants on domestic scheduled air transport services during the last five completed schedule periods.

4.7. An Analysis of India's Journey of Liberalisation

4.7.1. Benefits of Liberalisation

International air transport policies were motivated by the notion of flag carriers and that it was the government's responsibility to ensure air connectivity even on international routes even if that came at a cost of losing taxpayers' money – a social obligation so to speak. But as the market share and financial performance of the flag carriers deteriorated, the protectionist approach gradually started to fade and was replaced by a liberal market access expansion policy. With this approach, not only Indian carriers but also foreign carriers got more access to India's international traffic, thereby offering customers the benefit of choice and a competitive industry. This also solved the issue of capacity shortage. The benefits of semi-liberalisation that started in 2003 gradually paid off as evidenced by the steep increase in India's international passenger traffic post-2003 (Chart 3.16).

Chart 3.16: India's International Traffic and Share of Indian and Foreign Carriers (2003-21)



Source: DGCA, India

With the entry of private players in the international aviation market, the share of Indian carriers in international traffic, which had fallen below 30% prior to 2003, also gradually started to

increase as evident from the above chart. India has reached the stage where its carriers are rightly utilising their entitled share with 48.2% market share in India's total international passenger traffic in 2021.

Apart from these general benefits of international liberalisation, several studies have demonstrated the positive impact of air service liberalisation on the industry and the economy in general and on specific routes as well. The study conducted by InterVistas at the behest of IATA has concluded that the liberalisation of ASAs around the world has led to increased traffic growth.[752] The growth typically averaged between 12-35% higher than the years preceding liberalisation. In many cases, the growth rate even exceeded 50%.[753] The study also conducted a simulation of the likely result of an open skies-type liberal arrangement between three hundred and twenty country pair markets that were not liberalised at the time of the study. It was found that liberalisation of only those ASAs could have led to a 63% traffic growth rate as compared to the 6-8% prevailing rates under the restrictive ASAs.[754] Such liberalisation also has the potential to create 24.1 million full-time job opportunities and generate an additional USD 490 billion in GDP.[755]

A similar study was conducted by InterVistas on India as well in 2009. The study concluded that international market access liberalisation in India could lead to a 42% increase in international traffic over the 2007 levels,[756] a 31% drop in average fares,[757] higher customer choice and the creation of 910,000 direct and indirect new jobs.[758] While the study on India by InterVistas, was based on mathematical projections, time has shown that liberalisation did in fact benefit the sector. As shown in the graph earlier, India's international passenger traffic has grown by 135% from 2007 to 2018 (pre-pandemic level).[759] With respect to the liberalisation of the India-UK ASA in 2004, a study by the UK Civil Aviation Administrator (CAA) found that carriers have carried a significantly higher number of passengers at a lower passenger yield. This denotes an increase in traffic and a decrease in fares. The CAA also found that liberalisation on UK-India routes did not cause any market exits for the carriers operating on

[752] InterVISTAS, *The Economic Impact of Air Service Liberalization* at 2.
[753] *Ibid* at 14.
[754] *Ibid* at 2.
[755] *Ibid* at 2.
[756] InterVISTAS, *Liberalization Report: The Impact of International Air Service Liberalization on India* (July 2009) at 12 [*InterVISTAS India*].
[757] *Ibid* at 22.
[758] *Ibid* at iv.
[759] See chapter 3, chart 3.16, *above.*

these routes and in fact, these carriers increased the number of routes and capacity.[760] Similarly, the open skies agreement with the US led to a growth of traffic by 80.15% from 655,00 in 2002 to 1.18 million in 2005.[761] American carriers expanded their operations to India. Prior to the open skies agreement, among several US carriers, only Delta Airlines and Northwest operated flights to and from Mumbai. Post-liberalisation, American Airlines and Continental Airlines also launched non-stop services to Delhi and Mumbai.[762]

4.7.2. Code-Sharing and Alliances

Another important benefit of liberalisation is commercial agreements between airlines, with the most common ones being alliances and code-sharing agreements. A code-sharing agreement is an agreement between two airlines wherein one carrier (marketing partner) uses its flight code and markets seats on a flight operated by another carrier (operating partner).[763] There are several benefits to a code-sharing agreement. Most airlines enter into code-share agreements to expand global route coverage and serve on international routes. Seats on the flight of the operating carrier are sold by the marketing carrier to either provide further connections to complement its own network where it does not operate or to reduce competition.[764] Such agreements allow an airline to expand its service network and route coverage where they do not operate either due to regulatory restrictions or due to conscious business decisions.[765] These agreements generate revenue for partner airlines through market expansions, traffic feeds, improved connectivity, multiple listings on Computer Reservation System (CRS) screens, etc. It also allows the airlines to reduce costs by consolidating traffic, joint advertisements and resource sharing.[766]

Unlike code-sharing agreements which are usually between two carriers, airlines may also enter into alliances with a group of other airlines. Arguably, the top three global alliances are Star Alliance, OneWorld and SkyTeam. Most major airlines are part of one of these alliances. Global alliances vary in their scope and nature of commercial cooperation, nevertheless, some of the features of any alliance are code-sharing agreements with all partner airlines of the alliance; increased market access and enhanced timetable for partner airlines; flight schedule

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[760] UK, Civil Aviation Authority, *India Air Services: A Case Study in Liberalisation* (22 November 2006) [*UK-India Case Study*].
[761] Mazumdar, *supra* note 450 at 84.
[762] *Ibid* at 69.
[763] Li Zou & Xueqian Chen, "The Effect of Code-Sharing on Airline Profitability" (2017) 58 Elsevier J Air Transport Management 50 at 50.
[764] *Ibid* at 51.
[765] *Ibid.*
[766] *Ibid*.

coordination; cost saving by allowing economies of scale; mutual recognition of the frequent flyer programme and rewards; resource sharing like maintenance facilities, CRS, joint sales offices, yield management systems, airport lounge access etc; joint procurement (purchase of fuel, catering, etc.); common marketing and advertisement; and coordination of cargo operations.[767]

There are two ways by which liberalisation helps airlines enter into such commercial agreements. *Firstly,* as a general rule, restrictive ASAs do not authorise airline alliances, which acts as a barrier to competitive entry and expansion in the international market.[768] Liberalised ASAs or open skies agreements, on the other hand, have explicit clauses that pave the way for airlines to enter into commercial agreements like code-share and global alliances without any regulatory barrier. For example, the US-India open skies agreement has the following clause:[769]

> Article 8(7): In operating or holding out the authorized services on the agreed routes, any designated airline of one Party may enter cooperative marketing arrangements such as blocked-space, code-sharing or leasing arrangements with (a) an airline or airlines of either Party. (b) an airline or airlines of a third country; and (c) a surface transportation provider of any country;

Secondly, commercial agreements between airlines are based on the principle of reciprocal sharing of benefits. Only if all the partner airlines benefit equally would a commercial agreement be successful. For example, the global alliance SkyTeam explicitly states that 'quality…network compatibility, and the growth potential of a candidate member' are deemed the most important factors for determining membership.[770] Liberalisation of ASAs allows airlines to expand their network to different destinations, offer higher capacity, improve the quality of services through competition and expand their resources to meet the capacity requirements. Therefore, airlines of countries which have negotiated a higher number of liberal ASAs have greater market access to different parts of the world and, as a result, are more likely to be preferred as partner airlines for commercial agreements compared to airlines of those countries with restricted traffic rights.

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[767] Klaus Keller, *Regulatory Aspects of Airline Alliances: A Case Study of Star Alliance* (LLM Thesis, McGill University Institute of Air and Space Law, 2000) [unpublished] at 23-30.
[768] OECD, *Air Service Agreement Liberalization and Airline Alliances* (Paris: International Transport Forum, 2014) at 33.
[769] *India-US Open Skies Agreement*, *supra* note 729.
[770] "FAQs General Alliance" online: *SkyTeam* <https://www.skyteam.com/en/about/faq/general-alliance-questions>

Chart 3.17: Number of Code-share Partners of Major Indian Carriers (2022)	
Major Indian Carrier	**Number of Code-share Partners**
Air India	20
IndiGo	7
SpiceJet	1
Air Vistara	5
GoAir	0
AirAsia India	0
Source: Website of the Airlines	

Probably due to the restrictive approach to international liberalisation until very recently, Indian carriers have fared poorly in entering into commercial agreements with foreign airlines. Out of all India's international airlines, only Air India is part of a global alliance – Star Alliance.[771] Other Indian carriers have entered into commercial agreements like interlining and code-sharing agreements, however, the number of agreements is significantly lower than its US counterparts with the exception of Air India (Chart 3.17). On the other hand, major US carriers like Delta Airlines[772] and American Airlines[773] have twenty-one and twenty-three code-sharing agreements respectively with other airlines. This difference itself reinforces the argument that liberal ASAs foster commercial cooperative agreements among airlines.

4.7.3. India's Half-Baked Approaches: Comparison with the US and Recommendations

As mentioned above, there is no doubt regarding the benefits that liberalisation can bring to customers, carriers and the economy in general. At the same time given the global trend, there is also no escaping the path of liberalisation. So, the question that really arises here is whether the steps taken by the Indian government to liberalise the international air transport industry and the pace of liberalisation are economically sound. To answer this question, it is important to chronologically recall the steps taken by the government to gradually liberalise the industry.

India first embarked on the path of liberalisation with the domestic sector in the early 1990s. It was not until 2003 that liberalisation of the international sector commenced. Among the major steps taken were allowing private carriers with a minimum of twenty aircraft in their fleet and five years of experience to fly internationally and liberalising ASAs with countries like the US, UK and ASEAN countries.[774] While it is true that the 5/20 rule did bring competitive distortion, the rule as well as the decision to not liberalise domestic and international air transport industries simultaneously did not completely lack merit. Recalling the US experience of

[771] "Star Alliance Members" online: *Star Alliance* <https://flights.staralliance.com/en/members-codeshare>
[772] "Codeshare Partners" online: *Delta Professional* <https://pro.delta.com/content/agency/us/en/agent-resources/partner-information/codeshare-partners.html>
[773] "Partner Airlines" online: *American Airlines* <https://www.aa.com/i18n/aadvantage-program/miles/partners/partner-airlines.jsp>
[774] See chapter 3, para 4.3, *above.*

international deregulation which happened almost simultaneously with domestic deregulation, in the initial years of liberalisation, US carriers significantly lost market share to foreign carriers and foreign carriers got access to lucrative US routes. Moreover, traffic volume also did not increase significantly to offset the loss in market share. However, it benefitted the customers who were offered more choices and better connectivity.[775]

Turning to India, unlike the US, where the industry since the beginning was operated by private players, private carriers in India were allowed scheduled operations only from 1994 onwards. These airlines entered a new market which had been only catered to by the government carriers.[776] The new entrants did not have any predecessors to look back to. Given the typical circumstances, it is understandable for the government to have been wary about allowing private carriers which recently commenced operations to allow them to expand their business on international routes. With an extreme capacity shortage in the domestic market,[777] multiple market failures, which are a common trait of deregulation, could not be afforded at that time. Therefore, it is the author's opinion that the decision not to deregulate international and domestic markets at the same time allowed the newly launched private carriers to scale up their businesses, understand the market and gain the requisite experience before entering and competing with foreign mega-carriers which were operating on international routes for a long time and were prone to competition. The intention behind the five years' experience is also justified on the same grounds. The late 1990s and early 21st century witnessed several market exits and entries.[778] The 5/20 rule was merely an instrument for the government to ensure domestic connectivity was maintained and that airlines do not abandon domestic routes in pursuit of lucrative international ones. Thus, the five years experience policy was the government's protectionist approach towards the new carriers that had just started building their businesses in the hope that domestic experience and competition would prepare them for the fierce competition on international routes.

The consequences of liberalising the ASAs with the US and UK reinforce this argument. The US and UK deregulated their industry in the 1970-80s and through market consolidation and experiences in the domestic and international markets, carriers in these countries emerged as strong, competitive mega-carriers with ample resources. The Indian carriers when they started competing on these routes, even with five years of experience, were unable to take advantage

[775] See chapter 1, para 7.3, *above.*
[776] See chapter 3, para 4.3, *above.*
[777] See chapter 2, para 4.1.2, *above.*
[778] See chapter 3, para 2.2 & 3.3, *above.*

of the liberalised market access policy. It is true that the number of international passengers and connectivity on these routes increased, but the majority of the passengers were carried by foreign carriers[779] and in the initial years the share of Indian carriers remained low.[780] Unfortunately, there is no data on the share of Indian and US carriers on India-US routes, but the sheer fact that India had designated only Air India and Jet Airways to fly to the US under the multiple designation clauses whereas the US had designated four major airlines (American Airlines, Continental Airlines, Delta Airlines and Northwest)[781] demonstrates that US carriers stood to gain heavily from the open skies agreement compared to India. Within a year of signing the open skies agreement, US carriers jumped into this opportunity with Delta Airlines starting new connections between New York and the southern Indian city of Madras, while Northwest started a non-stop connection between Minneapolis and India's IT hub Bangalore. Continental Airlines also launched daily non-stop flights between New Delhi and New York.[782] Even the study conducted by UK CAA on India-UK ASA liberalisation concluded that the share of UK carriers increased but did not have any similar conclusion about Indian carriers.[783] Notwithstanding the loss of market share of Indian carriers, the liberalisation with US and UK significantly increased passenger traffic between the two countries and benefitted customers with more choices.

The experience with the US goes on to show the importance of liberalisation and at the same time the need to take prudent steps to ensure that not only consumers but also carriers benefit from such arrangements. Fast forward to 2016, realising the importance of liberalisation as well as the need to take cautious steps to protect the home carriers, the government agreed to enter into open skies agreements with SAARC countries and countries beyond the 5000 km radius.[784] This policy of having liberal arrangements with countries based on their geographic location but not limited to just regional geography is unique to India and in contrast to global practices. Most countries either enter into liberal agreements on a case-by-case basis according to the traffic demand or on a regional basis by signing regional multilateral open skies agreements. Other countries like the US negotiate liberal agreements with countries across the globe. India's

[779] See chapter 3, chart 3.16, *above.*
[780] *Ibid.*
[781] See Chapter 3, para 4.7.1, *above.*
[782] "India, US Sign 'Open Skies' Aviation Agreement" (18 April 2005), online: *CAPA* <https://centreforaviation.com/analysis/reports/india-us-sign-open-skies-aviation-agreement-8>
[783] *UK-India Case Study*, *supra* note 760.
[784] See Chapter 3, para 4.5, *above.*

unique selection of countries to negotiate open skies agreements (SAARC countries and countries beyond a 5000 km radius) is arguably half-baked with multiple flaws.

While the policy is silent on any justification behind selecting countries beyond a 5000 km radius, it *prima facie* appears that the government cautiously avoided countries like the UAE, Qatar, Singapore, Turkey, China, Thailand, Hong Kong and Malaysia which lie within the 5000 km mark while still attempting to liberalise ASAs with rest of the world. It appears that the policymakers were wary of the potential of the foreign carriers of these countries and their hub airports to funnel Indian traffic from India through their hub airports and world-class airlines to the final destinations elsewhere in the world using the sixth freedom rights.[785] Such a fear is not entirely without merits. India's primary long-haul operators were Air India and Jet Airways. With Jet Airways suspending operations, Air India, even after deploying all its capacity, was able to carry only around 10% of all foreign travellers to and from India between 2016-2020.[786] Though the ASAs do not discriminate against Indian carriers exercising their sixth freedom rights, they simply do not have enough capacity to compete with the mega-carriers and their enhanced hub and spoke approach. Therefore, in an attempt to protect home carriers from the fierce competition of world-class airlines, the government insisted on having capacity and route restrictions and not liberal open skies arrangements with these selected countries.

Acknowledging the importance of this protectionist approach of the government to protect its home carriers, it is the author's opinion that the 5000 km rule does a half-baked job. The concern about foreign carriers' share increasing in India's international traffic is genuine. But avoiding a few select countries with world-class airports and airlines does not solve the issue at hand. There are several other countries beyond the 5000 km mark which also have terrific hub airports and airlines *viz* France (Paris), the UK (London Heathrow), The Netherlands (Amsterdam), Germany (Frankfurt) and the US, to name a few. These are some of the busiest hub airports beyond the 5000 km mark in terms of international traffic as ranked by the Airports Council International.[787] The impact of the liberalisation of ASAs with the UK and the US on Indian carriers strengthens this argument. Open skies agreements with countries (even beyond a 5000 km radius) having strong carriers and airports pose a number of potential risks. Indian carriers face several problems including performance, capacity, and regulatory burdens. There

[785] See appendix, *below.*
[786] See India, DGCA, *Air Transport Operating and Traffic Statistics for the Year 2020-2021 Fleet, Personnel & Financial Statistics* (New Delhi: 2021).
[787] "ACI Releases Preliminary 2016 World Airport Traffic Rankings", online: *Airports Council International* <https://aci.aero/2017/04/19/aci-releases-preliminary-2016-world-airport-traffic-rankings-robust-gains-in-passenger-traffic-at-hub-airports-serving-trans-pacific-and-east-asian-routes/>

is also a lack of infrastructure like hub airports that becomes an obstacle for the industry to make the best of its potential. Furthermore, most of the Indian carriers are young with less than two decades of experience. Given the nature of the Indian aviation industry, the concern is legitimate that Indian carriers may not be competitive enough to compete with their global counterparts. India, with its huge population and being the third largest aviation market in terms of passengers in the world, can immensely benefit the foreign airlines that have the capability to provide the required capacity and price and divert traffic from the home carriers. Therefore, the government needs to adopt a pragmatic, gradual, limited and reciprocal approach in dealing with liberalisation to counter the imbalance of benefits that foreign carriers might get to the disadvantage of Indian carriers.

In light of this argument and the importance of protecting home carriers but also acknowledging the importance and benefits of international air transport liberalisation, it is recommended that the government should take slow and cautious steps in selecting countries to enter into open skies agreements. It is recommended that the government should first start by liberalising open skies agreements with regional countries, and with countries where Indian traffic demand is higher. It is important to relook at the decision to not enter into open skies agreements with countries within the 5000 km radius as data shows that Indian carriers have utilised not 80% but 100% of their capacity entitlement with countries like Dubai, Qatar, Sharjah, Thailand, Singapore, and Kuwait.[788] Open skies agreements on these short-medium haul routes would benefit Indian carriers more than with countries beyond the 5000 km mark. This is because, apart from Air India and Air Vistara, most of the other Indian carriers tend to focus on short-medium haul routes.[789] It is important to negotiate liberal agreements on a case-by-case basis where Indian carriers can benefit, rather than adopting an umbrella policy. With countries where foreign carriers have utilised their share of capacity entitlement, Indian carriers must be incentivised to fly on those routes but at the same time to keep pace with the increasing traffic demand, foreign carriers should be allowed to go beyond their capacity entailment. This would allow the Indian carriers to gradually get habituated to competition while giving adequate choice and connectivity to customers. The government must also encourage carriers to increase their capacity to cater to the growing traffic. In this respect the removal of the 5/20 rule at this stage is laudable. But as recommended earlier, entry barriers must be reduced to allow more entities to enter the market which would eventually lead to greater capacity.

[788] India, Ministry of Civil Aviation, *Annual Report 2018-19* (New Delhi: 2019) at para 1.5.1.
[789] See International Destinations/Routes of Indian Carriers (IndiGo, SpiceJet, GoAir, AirAsia, Air Vistara, Air India).

CONCLUSION

The thesis over the course of three chapters elaborated upon the US and the Indian experiences of airline deregulation both in the international and domestic markets. Since the US deregulated the industry as early as 1978, there exists considerable evidence about the effects of such deregulation for countries at varying stages of economic liberalisation. This experience is valuable for policymakers in India who are still in the process of gradually liberalising the industry. However, the challenge is to learn from this experience while devising policy initiatives bearing in mind the typical developmental needs that differentiate India from the US. It is reiterated that mindless deregulation can have negative impacts. Therefore, it becomes increasingly important to differentiate and appreciate the economical and financial constraints faced by India that hinder the process of liberalisation.[790] Other differentiating factors affecting the aviation industry include *inter alia* size of the countries, demographics, infrastructure, per capita income, level of government interference in industrialisation, price sensitiveness of customers and surface transport connectivity. These differences cannot be ignored when comparing the air transportation industry in the US to that in India.

Irrespective of the differences, the US experience cannot be disposed of merely because the two countries are at different stages of economic development. India has a sizable portion of its vast population that can afford air travel, and the scale of the Indian market is comparable to that of the US. India, being the third largest aviation market in the world, is not much behind the US in terms of the size of the market.[791] Both countries also face similar problems of having a higher concentration of traffic on a small number of routes, thereby jeopardising regional connectivity.[792] Analysis of the Indian and US experiences has shown that, in the long term, liberalisation has benefitted both countries. Both have experienced a boost in air connectivity, a reduction in airfares, and a greater number of players in the market, which ultimately impacted the consumers and the economy in general.[793] While the motivations for deregulation in both countries were significantly different, it appears that some of the goals underlying US deregulation (benefit of consumers) have been met in India, even if that was not the primary reason for undertaking deregulation in India.[794] Moreover, India's primary goal of deregulation - overcoming capacity constraints - was also a success. In terms of the negative effects of

[790] See chapter 2, para 4.2, *above.*
[791] See chapter 3, para 4.7.3, *above.*
[792] See chapter 1, para 6.4.3 & chapter 3, para 2.3, 2.4, *above.*
[793] See chapter 1, para 6.4 & chapter 3, para 3.3, *above.*
[794] *Ibid.*

deregulation, the US and Indian experiences are also comparable. Both countries witnessed numerous entries in the initial years, followed by a period of financial difficulties and market exits leading to market concentration.[795]

India's approach to liberalization is laudable and deserves recognition as it did not blindly emulate western practices. Instead, it opted for a gradual process, closely monitoring the impact of policy changes on the aviation industry. Not having an industry completely devoid of economic regulations helps India in several aspects, particularly in ensuring regional connectivity.[796] Certain regulations on international air transportation discussed earlier protect India's home carriers from fierce competition in the international market.[797]

However, the existence of some regulations at this stage is critiqued and seems unnecessary, the most important being the one creating entry barriers. It appears that through fleet and equity requirements, the government wants to reduce market failures, but there is a need to recognise that liberalisation of entry is merely an interim stage in the process of reforms, and deregulation is likely to involve some unsuccessful ventures. It remains an ugly attribute of any deregulation, and the risks must be taken for the greater benefit. Evidence has shown that entry requirements have failed to stop market failures but instead impeded competition.[798] Furthermore, the regulation on regional connectivity – the RDG - though was necessary at an earlier stage now seems redundant, especially with the adoption of the new scheme – RCS. RDG not only adds a burden to carriers but also goes against the spirit of deregulation at this stage.[799] The policy on open skies agreements with SAARC countries and countries beyond the 5000 km mark is also arguably flawed.[800]

In conclusion, based on the evidence presented in this thesis, it appears that India is ready for a more liberalized domestic aviation industry. However, it is important to acknowledge that certain limitations are still required in the international arena, where Indian airlines face stiff competition from foreign mega-carriers. Additionally, a cautious and strategic approach is crucial when negotiating open skies agreements with other countries. Overall, India can benefit greatly from a more deregulated aviation industry, but it must proceed thoughtfully to ensure the best possible outcomes.

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[795] See chapter 1, para 6.4.1 & chapter 3, para 2.1, 2.2, 3.3, *above.*
[796] See chapter 3, para 2.4, *above.*
[797] See chapter 3, para 4.4, 4.7, *above.*
[798] See chapter 3, para 2.1, 2.2, 3.3, *above.*
[799] See chapter 3 para 3.4.2.3, *above.*
[800] See chapter 3, para 4.7.3, *above.*

APPENDIX

Freedoms of the Air:[801]

1st Freedom: It refers to the right or privilege granted by one State to carriers of another State to fly across its territory without landing.

2nd Freedom: It refers to the right or privilege granted by one State to carriers of another State to land in its territory for non-traffic purposes.

3rd Freedom: It refers to the right or privilege granted by one State to carriers of another State to put down, in the territory of the first State, traffic coming from the home State of the carrier.

4th Freedom: It refers to the right or privilege granted by one State to carriers of another State to take on, in the territory of the first State, traffic destined for the home State of the carrier.

5th Freedom: It refers to the right or privilege granted by one State to carriers of another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State.

6th Freedom: It refers to the right or privilege of transporting, via the home State of the carrier, traffic moving between two other States.

7th Freedom: It refers to the right or privilege granted by one State to carriers of another State of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e., the service need not connect to or be an extension of any service to/from the home State of the carrier.

8th Freedom: It refers to the right or privilege granted by one State to carriers of another State of transporting cabotage traffic between two points in the territory of the granting State on a service which originates or terminates in the home country of the foreign carrier or outside the territory of the granting State.

9th Freedom: It refers to the right or privilege granted by one State to carriers of another State of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State.

> ***Note:*** *The 1st and 2nd Freedoms of Air are referred to as transit freedoms/rights. Freedoms 3-9 are referred to as traffic freedoms/rights. ICAO officially recognises only the first five freedoms as they are recognised as such by international treaties. ICAO refers the remaining freedoms as the 'so-called freedoms' of air.*

[801] "Freedoms of the Air" online: *ICAO* <https://www.icao.int/pages/freedomsair.aspx>

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