Competition Commission of Pakistan
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AVIATION INDUSTRY IN PAKISTAN

A VIEW THROUGH AN EFFICIENCY & COMPETITION PRISM

Prof. Richard Janda
McGill University, Canada

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Foreword

To better understand the competition conditions in the ‘relevant markets, the Competition Commission of Pakistan (CCP) initiated a series of competition assessments. The studies so far completed include important sectors of Pakistan’s economy, such as banking, fertilizer, power, sugar, cooking oil and ghee, and the polyester staple fiber industry. The CCP examines various sectors from a competition standpoint to identify competition vulnerabilities and government interventions that may distort incentives; information asymmetries and anti-competitive elements prevailing in the industry are also explored. The sectoral studies help CCP assess the degree of competition, and the measures required to enhance competition in specific sectors.

This study is a competition assessment of the ‘Aviation Industry’ - an important segment of the broad transport and communication market. It focuses on a wide range of competition issues including market dominance, entry barriers in the national market, and developments in the international aviation industry. It also sheds light on the regulatory mechanism, and the weaknesses that should be removed to make the aviation industry competitive and vibrant.

Like our earlier studies, this Report has been written for policy makers, including both the legislative and the executive branches. It should also be beneficial for those with a particular interest in the aviation sector – investors, existing and potential market entrants, academia and students.

The Report has been compiled by Professor Richard Janda of Mc. Gill University, Canada. The valuable comments from Mr. Afsar Malik, General Manager, Civil Aviation Authority, and Dr. Joseph Wilson, Member, CCP are gratefully acknowledged. Ms. Kishwar Khan, Director, CCP strived to finalize the Report under the supervision of Mr. Mueen Batlay, Member, Competition Policy and Research Department of the CCP; without their efforts this Report would not have been possible.

Rahat Kaunain Hassan
Chairperson
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I. CIVIL AVIATION IN PAKISTAN

Pakistan is a South Asian State that covers almost 800,000 square kilometers, and is home to the sixth largest global population, which is estimated to have recently exceeded 169 million people.[1] Land borders are shared with Afghanistan, China, Iran and India.

Air transportation is in a transition period in Pakistan, as the country is trying to balance efficiency and consumer benefit that can be gained from market liberalization with the need to ensure that service is safe and reliable. Currently, there are three scheduled airlines in Pakistan, and each of these operates both domestic and international flights. One of these, Pakistan International Airlines (PIA), is the flag-bearing national airline that remains approximately 89.93% government owned, with the remainder of the shares being held privately and listed on Pakistan's three stock exchanges. The airline was launched in 1955 as a government initiative, formed through merging with the existing privately owned Orient Airways.[2] The airline has a fleet of 39 aircraft, of which 26 are wide body jets, 6 are narrow body jets, and 7 are turboprop regional airliners.[3] PIA has just under 40% of the market share of international travel originating and terminating in Pakistan, however domestically its dominance extends to almost 75%.[4]

The other two airlines are privately owned, offering both domestic and international flights. Shaheen Air International was established in 1993 and today operates nine aircraft, and Air Blue was founded in 2004 and has a fleet of eight aircraft.

The Civil Aviation Authority of Pakistan was established in 1982, assuming the functions that were previously exercised by the Department of Civil Aviation, which was part of the Ministry of Defence. The CAA has three organizational pillars: it is a regulatory body responsible for the certification and oversight of air carrier practices in Pakistan, however it also acts as the provider of both airport and air navigation services. These functions are being separated so that the CAA can independently carry out its regulatory and supervisory role. This process was

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[1] Government of Pakistan Population Census Organization estimates population at 169,393,000, making Pakistan the sixth most populous country in the world. Online: Government of Pakistan Statistics Division < http://www.statpak.gov.pk/depts/pco/>.

[2] History of Pakistan International Airlines (PIA), online: PIA <http://www.piac.com.pk/PIA_About/pia-about_History.asp>.

[3] Data accessed on 03 May 2010 online: Air Fleets <http://www.piac.com.pk/PIA_About/pia-about_History.asp>.

[4] See the decision of the Competition Commission of Pakistan (CCP), page No. 9. Available at: http://cc.gov.pk/images/Downloads/PIA%20Rescheduling-Cancellation%20Order%20[8%20Dec%202009].pdf

given a high priority in the restructuring of the CAA that began in 2006.[5]

A national aviation policy has been articulated by the CAA. The foundational principles of the policy are to ensure safe domestic and international transportation with improved consumer choice, while protecting against anticompetitive firm conduct.[6] Any operator must have at least three aircraft, and at least one of these must be registered in Pakistan, however wet leasing of further aircraft is allowed. All private airlines are required to operate a minimum number of fixed trunk routes within Pakistan, and a minimum number of designated domestic socio-economic routes. If these conditions cannot be met, then the private airline is required to pay a penalty to PIA. Under the policy, PIA is given preference for designation as the applicable carrier on international routes, although private airlines may operate any unused or additional capacity available under Pakistan's bilateral international air service agreements.[7]

In 2007, the CAA Board formulated a new Draft National Aviation Policy for Pakistan.[8] Amongst the priorities of this reform were to ensure that entrant airlines were serious undertakings that could provide reliable public service. In order to ensure that this was the case, required startup capital was increased fivefold to 500 million rupees, the minimum number of aircraft was increased to four for international carriers, and wet leasing was limited to all-cargo operations, thus making Pakistani registration of aircraft mandatory for all passenger airplanes. As compensation, however, market access was facilitated for upstart airlines, with the requirement of payment of a penalty to PIA for not serving designated domestic routes lifted, and equal access to international markets granted. These changes, however, have not been enacted by the Cabinet to date, and thus the earlier policy remains in force.

Aviation has the potential to expand greatly in Pakistan. The sector has not grown in tandem with that of other countries, such as India. There is scope for considerable increase of service, both within and internationally from Pakistan as the country's geographical location is ideal to attract transit as well as origin and destination traffic. Aviation policy should be directed towards invigorating the competitiveness of both domestic and international aviation sectors.

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[5] Pakistan Civil Aviation Authority, Restructuring the CAA, PowerPoint presentation on file with author.

[6] Draft National Aviation Policy (Pakistan) online: Pakistan Civil Aviation Authority <http://www.caapakistan.com.pk/regular_public_air_transport_license.aspx> §2.

[7] Pakistan Civil Aviation Authority, National Aviation Policy S. 6, online: CAA Pakistan < http://www.caapakistan.com.pk/AviationPolicyView.aspx>.

[8] Pakistan Civil Aviation Authority, Draft National Aviation Policy, online: CAA Pakistan < http://www.caapakistan.com.pk/Format2/Draft%20NAP.pdf>.

II. BACKGROUND OF INTERNATIONAL REGULATION OF AIR TRANSPORTATION

An international regulatory framework emerged from the International Civil Aviation Conference held in Chicago from November 1 through December 7 1944. The 54 nations present at the Conference succeeded in achieving a consensus on key issues, including the creation of the International Civil Aviation Organization (ICAO). One issue of contention, however, related to access to international aviation markets.

There was no agreement that States should have the legal right to serve the territory of other States, and as such the resulting Convention on International Civil Aviation[9] (Chicago Convention) did not deal with exchange of air traffic rights.

Two parallel agreements were contemporaneously concluded in Chicago. The Transit Agreement provided for the right of States to fly over and to make non-traffic stops in Member States.[10] Although this agreement was widely ratified by States, it still does not provide for commercial international aviation market access. A second agreement, known as the Transport Agreement, did exchange generous market access privileges amongst its signatories.[11] State Parties to the Transport Agreement agreed multilaterally to exchange unrestricted market access with respect to the third, fourth and fifth freedoms of the air, thus allowing services to leave the home State, carry traffic to the partner State, continue onwards to third destinations with traffic rights and then return to the home State through the partner State. Although the Transport Agreement came into force, it only attracted 19 signatures, of which 8 States have since denounced their signature.[12] Pakistan ratified the Transit Agreement in 1947, when it also became a party to the Chicago Convention, but has never signed the Transport Agreement.

States were left to negotiate trade in aviation services amongst themselves. An agreement concluded between the United States and the United Kingdom in Bermuda in 1946 became the

[9] Convention on International Civil Aviation, 7 December 1944, 15 UNTS 295.
[10] International Air Services Transit Agreement, 7 December 1944, 84 UNTS 389.
[11] International Air Transport Agreement, 7 December 1944, 171 UNTS 387.
[12] See International Air Transport Agreement, List of Parties received from depositary Government of the United States, online: International Civil Aviation Organization [ICAO], < http://www.icao.int/icao/en/leb/Transport.pdf>.

benchmark of international negotiations.[13] Over the following thirty years, governments aggressively negotiated bilateral agreements, usually hoping to secure advantage for their national carrier, which was in almost all cases -except that of the United States -government owned. Pricing, capacity, designation and routes were all subject to strict government approval.

This approach first started to change after the United States opened up its domestic markets in 1978, to what at least initially was broad acclaim of improved service and reduced fares.[14] A first wave of international liberalization spread in the late 1970s. Difficult economic conditions halted the spread of liberal aviation policy in the 1980s.[15] However, a second major step was taken when the European Union assumed control of intra-EU air transportation. The EU developed a three-stage liberalization timeline, which commenced in 1987 and concluded in 1997, with the establishment of a single aviation market throughout the EU, wherein any carrier of any Member State was free to serve any city pair within the Community including within another Member State.[16]

In 1992, the United States resumed with increased vigour its attempts to secure free market access air service agreements. The crux of these agreements is to allow third, fourth and fifth freedom traffic rights without controls on capacity, pricing, designation or routes.[17] Simultaneously, in the late 1980s and early 1990s, another transformation was underway as many of the world's largest government-owned airlines were undergoing a privatization process.[18] This reduced the incentive for governments to negotiate restrictive air services agreements, and a number of States pursued open skies, although not on a universal scale like the United States, which has now succeeded in securing open skies agreements with 94 States

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[13] Agreement between the Government of the United Kingdom and the Government of the United States Relating to Air Services between their respective Territories (Bermuda I), Bermuda, 11 February 1946, reprinted at XXX:I Annals of Air & Space L. 297 (2005).

[14] See Paul S. Dempsey, Airline Deregulation and Laissez-faire Mythology (Westport: Quroum, 1992).

[15] See Brian F. Havel, In Search of Open Skies : Law and Policy for a New Era in International Aviation (The Hague: Kluwer, 1997).

[16] Market access in the European Union was prescribed by the EC, Council Regulation (EEC) #o 2408/92 of 23 July 1992 on access for Community air carriers to intra (Community air routes [1992] O.J. L. 240/8, amended by Regulation (EEC) 2408/92, OJ L 240/8 of 24.08.1992, amended by regulation (EC) 1791/2006, [2006] O.J L 363/1 (re. accession of Bulgaria and Romania). The 1992 legislation provided for ongoing; limits on cabotage rights through 1 April 1997 when the singe aviation market took full effect.

[17] See Model United States Open Skies Agreement, released by the Bureau of Economic and Business Affairs of the US Department of State, 10 January 2008, online: United States Department of State < http://www.state.gov/e/eeb/rls/othr/ata/114866.htm>.

[18] Early instances of full privatization included British Airways (1987), Air New Zealand (1989) and Air Canada (1989). See ICAO List of Government-owned and Privatized Airlines, online: ICAO < http://www.icao.int/icao/en/atb/epm/ecp/PrivatizedAirlines.pdf>.

including Pakistan, which in 1997 concluded a template open skies agreement with the United States.[19] This was updated in April 1999 to further liberalize air cargo traffic rights up to the seventh freedom.[20]

Since 2000, developments have been centered in Europe, where most notably the Council of the European Union has granted the Commission powers to negotiate bilateral air service agreements on behalf of all 27 Member States.[21] The Commission has already secured liberal aviation arrangements with Morocco, the United States and Canada.[22] Furthermore, the single aviation market is progressively being expanded beyond the borders of the European Union, through the European Common Aviation Area agreements.[23]

Thus the global aviation market has progressed enormously in the past twenty years, with liberalization especially marked -but not limited to -the most developed countries. Attention must now turn to the international Pakistani aviation market, for which we will first overview current data before studying the regulatory framework in place through Pakistan's domestic and international legislation.

III. INTERNATIONAL CIVIL AVIATION IN PAKISTAN: A STATISTICAL OVERVIEW

Twenty-four airlines currently operate international services to Pakistan. Three of these airlines are Pakistani; the government owned Pakistan International Airlines (PIA); Air Blue; and Shaheen Air. Three carriers are Emirati, and seven other airlines come from the Gulf/Persian States. Other major international carriers serving Pakistan are Thai Airways International, China

[19] US-Pakistan Air Transport Agreement of 10 April 1997, online: United States Department of State, < http://www.state.gov/documents/organization/114302.pdf>

[20] Pakistan Note 405 of 12 April 1999, online: United States Department of State, <http://www.state.gov/documents/organization/114266.pdf>.

[21] The Council had long denied the Commission a mandate to negotiate air transport agreements on behalf of all Member States, however this position was reversed after the European Court of Justice found that Open Skies Agreements concluded by Member States with the United States were in violation of Community Law in judgments passed on 5 November 2002.

[22] See Air Transport Portal of the European Commission, 'Status of Aviation Relations' by Country, online: European Commission, <http://ec.europa.eu/transport/air/international_aviation/country_index/country_index_en.htm>

[23] Multilateral Agreement between the European Community and its Member States, the Republic of Albania, Bosnia and Herzegovina, the Republic of Bulgaria, the Republic of Croatia, the former Yugoslav Republic of Macedonia, the Republic of Iceland, the Republic of Montenegro, the Kingdom of Norway, Romania, the Republic of Serbia and the United Nations Interim Administration Mission in Kosovo on the establishment of a European Common Aviation Area 2006 O.J. L. 285/3.

Southern and Air China. The only European carrier still operating into Pakistan is Turkish Airlines.[24]

Pakistan has 11 airports, which at the time of writing (October 2009) offer direct international services, others offer stopping service as a continuation of a domestic service. Six of these airports (Dera Ghazi Khan, Faisalabad, Gwadar, Quetta, Shaikh Zayed and Turbat) are served exclusively internationally by Pakistan International Airlines (PIA). No service from any of these airports is operated more frequently than three times per week. Bahawalpur, Faisalabad and Quetta all serve Dubai (UAE) only, Gwadar serves only Muscat (Oman), Shaikh Zayed only Abu Dhabi (UAE), and Turbat only Sharjah (UAE). Sialkot airport is served by both PIA and Shaheen Air, with the former serving Abu Dhabi and Kuwait, the latter serving Sharjah, and both airlines flying to Muscat. The maximum frequency any flight operates remains three times weekly.

The four significant international airports are Bacha Khan (Peshawar), Benazir Bhutto (Islamabad), Jinnah (Karachi), and Allama Iqbal (Lahore). Of these, Peshawar is the smallest and as of late March 2010 offers 62 weekly international services by 10 carriers, of which 7 are foreign airlines. This is significantly different from the autumn 2009 period when only one foreign carrier maintained service to Peshawar due to security concerns in the region. The three Pakistani carriers dominate the Peshawar market as they account for 45 of the weekly international services, whereas the 7 foreign airlines account for only 17 weekly services. Amongst the Pakistani carriers, Air Blue offers three services per week to Dubai; Shaheen Airlines connects to Abu Dhabi daily, Dubai four times per week, Al Ain and Sharjah three times weekly, Muscat twice per week and Doha once per week. PIA flies daily to Dubai, five times weekly to Abu Dhabi, twice weekly to Riradh, Al Ain and Doha and weekly to Jeddah, Kabul, Kuwait and Muscat. As of December 2011, the Singapore Airlines has already closed its operations to Pakistan. RAK Airways has recently commenced two weekly frequencies each to Lahore and Peshawar from Raas ul Khymah, UAE; Flydubai has eleven weekly flights to Karachi from Dubai. Eritrean Airlines has also started operations to Lahore and Karachi. NAS Air, a second Saudi national carrier has commenced operations to all the four major airports in Pakistan after expansion of bilateral arrangements between the two countries recently. Turkish

[24] Malaysian Airlines suspended its service in January 2012 for route rationalization reasons.

Airlines has commenced three weekly frequencies to Islamabad from Istanbul. This is in addition to four weekly flights to Karachi.

A. KARACHI JINNAH INTERNATIONAL AIRPORT

Karachi is the busiest Pakistani international airport with 165 international flights operating each week. 82 widebody services operate, of which 49 are operated by foreign carriers and 33 by PIA, the sole Pakistani operator to hold widebody aircraft. 59 flights serve Dubai, with four airlines competing in the market. The market is dominated by Emirates which operates 28 widebody flights per week to Dubai. PIA also operates a once-daily wide-body service and narrow aircraft are operated daily by Air Blue and Shaheen International. A further 16 flights serve the secondary UAE airports in Abu Dhabi and Sharjah. 13 flights are offered by Saudi Arabian Airlines to Riyadh, Jeddah and Dammam. Daily services to the Gulf are also offered by Qatar Airways, Oman Air, and Gulf Air.

The only European services out of Karachi are 4 narrow body services per week to Istanbul with Turkish Airlines, and three times weekly service to London Heathrow with PIA. For a long time, the Kuala Lumpur-Karachi sector remained one of only two contested Pakistan-Asia markets as both Malaysian Airlines and PIA offered 2 services per week. From January 2012, Malaysia Airlines has suspended its two weekly services to Karachi.[25] All other East Asian destinations are served by foreign carriers; Cathay Pacific connecting into Hong Kong, and Thai International operating 4 flights to Bangkok and Air China flying to Chengdu and on to Beijing. Karachi is the unique gateway from Pakistan to India (PIA serving Delhi and Mumbai), Sri Lanka (operated by SriLankan Airlines) and Bangladesh with three airlines (PIA, Biman and GMG Airlines flying to Dhaka). The only North American service out of Karachi is a once-weekly direct flight to Toronto offered by PIA.

B. LAHORE ALLAMA IQBAL INTERNATIONAL AIRPORT

Lahore supports 84 weekly international flights. 51 flights serve the Gulf area, of which 21 are

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[25] As ‘route rationalization’, the Airlines planned to withdraw from eight loss-making routes including Surabaya, Dubai-Damman, Langkawi-Penang-Singapore, Johannesburg, Cape Town-Buenos Aires and Rome. See, ‘The News International’, December 23, 2011, available at: http://www.thenews.com.pk/TodaysPrintDetail.aspx?ID=83662&Cat=3

offered by international airlines, and 30 by Pakistani carriers. 13 flights are operated into Europe, all by PIA. Four of these flights operate on a single frequency per week basis, and two flights continue to further points in Europe. The three UK destinations (Glasgow, London and Manchester) are served with greater frequency. Two Manchester-bound flights per week continue to New York, while there is one stand alone service weekly to Toronto. Six weekly connections are available to South East Asia, 4 flights to Bangkok offered by Thai Airways International and 2 flights by Singapore Airlines. In December 2011, RAK Airways also commenced 02 weekly flights to Lahore from Raas ul Khymah, UAE. NAS Air, a second Saudi national carrier and Eritrean Airlines have also started operations to Lahore.

Thus at Lahore Airport, of 84 weekly international services, 53 of these are provided by Pakistani carriers and 31 by international carriers. International carriers however still hold a majority of widebody services (25 weekly vs. 18). Asian destinations are catered for by the foreign carriers from that region whereas Europe and North America are served from Lahore only by PIA. PIA stands alone in offering a variety of destinations at the expense of frequencies as no other airlines operate once-weekly services. Of all of the city pairs out of Lahore Airport, only those into the Gulf are contested among carriers. The disequilibrium of widebody vs. narrow-body aircraft is most prominent in the Pakistan-Gulf markets, where international carriers provide 18 weekly widebody services, whereas there is a single widebody flight operated by a Pakistani airline.

C. ISLAMABAD BENAZIR BHUTTO INTERNATIONAL AIRPORT

The central Islamabad airport has 13 airlines operating internationally on 93 flights. The UAE is the most frequent destination with 42 weekly flights between its three international airports and Islamabad. 19 of these are provided by Emirati airlines. All three city-pairs are contested with 4 carriers serving Abu Dhabi, 3 serving Dubai and 2 competing to Sharjah. Other Gulf flights are dominated by foreign airlines operating 17 weekly flights compared to three by PIA. Europe is served by 17 PIA flights per week. These link 7 European cities directly, and three additional cities have stopping service as an extension of the direct services. The United Kingdom accounts for ten of these weekly PIA flights, and a further four flights per week are operated to Manchester by Air Blue, making Manchester the only contested European destination. Four of PIA’s flights operate on a once-weekly basis, which makes attraction of premium passengers especially difficult.

Thai Airways International is the only Asian carrier operating into Islamabad. PIA, however, has two weekly flights to Bangkok continuing to Hong Kong, and two services to Tokyo with a stop in Beijing. The only North American point served is Toronto to which PIA flies once-weekly. Turkish Airlines has commenced three weekly flights to Islamabad from Istanbul.

IV. INTERNATIONAL COMMERCIAL REGULATORY FRAMEWORK

For any carrier to provide international air transportation, authorization will need to be provided. Air Transport Agreement 1944 was not ratified by many states in the world, therefore it was finally annulled in 1953. There exist some multilateral agreements, but they are mainly regional. The Multilateral Agreement on Liberalization of International Air Transport (MALIAT) was signed on 1 May 2001 by Brunei Darussalam, Chile, New Zealand, Singapore and the United States of America. The rest of the world largely relies on bilateralism or regional multi-lateral agreements. In the case of Pakistan, reciprocal authorization would usually be granted by way of a bilateral air service agreement. However it is also necessary at an initial stage to consider the domestic legal regimes which define a Pakistani carrier, since ordinarily a State may only designate its own airlines to operate the air traffic rights gained through bilateral negotiations.

A. CERTIFICATION OF A PAKISTANI AIRLINE:

Pakistan domestic law allows foreign investment in Pakistani airlines, however this is capped at 49%.[26] This is a relatively liberal provision. It stands in line with the cap imposed by the European Union, Australia, Peru and China.[27] The rule remains more liberal that that in force in both Canada and the United States, where national ownership must exceed 75% of voting shares, but falls short of ultra-liberal States including New Zealand and Hong Kong which have

[26] Regular Public Air Transport License Requirements: “Foreign investment, if any, is allowed but not more than 49% of the paid up capital, to the extent where the controlling interest remains in local hands”. Online: Pakistan Civil Aviation Authority < http://www.caapakistan.com.pk/regular_public_air_transport_license.aspx>.
[27] ICAO Survey of Member States Policies concerning Foreign Ownership of Airlines, on file with author.

no minimum national ownership requirements.[28]

B. PAKISTAN'S BILATERAL AIR SERVICE AGREEMENTS:

This analysis of the bilateral patchwork that determines the rights of Pakistan's airlines to venture into international markets and the rights of international carriers to serve Pakistan will be studied in two stages. The first section examines the status of Pakistan's bilateral agreements on a system-wide basis, evaluating the relative liberalness of the agreements and relating this to traffic patterns. This study, based upon WTO econometric analysis of the ICAO World Air Service Agreements database, is however inherently flawed, in that the underlying data is unlikely to be comprehensive or fully updated since States have persistently demonstrated reluctance to respect their obligations flowing from the Chicago Convention and reinforced by ICAO Assembly Resolutions to register all international aeronautical agreements with ICAO.[29] Therefore, in a second stage, we will look at a small number of critical bilateral air service agreements of Pakistan with key trading partners in their current form.

1. Pakistan's ICAO-registered bilateral air service agreements

Member States of ICAO are obliged under the Chicago Convention to register all aeronautical agreements with the Organization. This encompasses bilateral air service agreements. 53 agreements to which Pakistan is a party have been registered with ICAO, which maintains a compendium of these agreements. This provides the best collection of data on air services agreements. However, it is important to note the caveats that States often neglect to register their agreements and amendments, and often there will exist memoranda of understanding and exchanges of notes, which can significantly modify the initial text of the agreement. Hence, the following analysis is illustrative, but the individual data contained therein cannot be relied upon as accurate.

In 2006, the World Trade Organization -pursuant to its mandate to review air transportation under the General Agreement on Trade in Services[30] – developed an Air Liberalization Index (ALI), which assesses the relative liberalness of air transportation agreements according to their

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[28] Ibid.
[29] Chicago Convention, Art. 81 & 83.
[30] General Agreement on Trade in Services: Annex on Air Transportation Services S. 5, available online: World Trade Organization < http://www.wto.org/english/docs_e/legal_e/26-gats_02_e.htm#annats>.

features. Elements of the bilateral agreements taken into consideration include the pricing regime applicable, the degree of governmental control of capacity, restrictions on the number of operators that can fly between country-pairs, the traffic rights exchanged, and foreign ownership restriction on designated airlines.

Pakistan is generous in its exchange of fifth freedom traffic rights, and these are foreseen in 46 of the 53 bilateral agreements. In 11 instances, Pakistan exchanges the right to designate two or more airlines on international routes, rather than upholding the single designation flag-bearing airline paradigm. However, Pakistan is more reluctant to include liberal terms on pricing, capacity and ownership in its bilateral agreements.

Of the 53 air service agreements registered with ICAO to which Pakistan is a party, 31 would be considered to have highly restrictive terms, as they have an ALI of between 0-6 out of 50 which would represent a fully liberalized market between two countries, such as exists amongst Member States of the European Union. A further 17 agreements can be found to have limited liberal terms with ALIs of 6-12. Four agreements – those registered between Pakistan and the UK, Macao, Singapore, and Iran -can be considered to contain multiple liberal terms, as they have an ALI of between 13 and 20. However, only one Agreement contained advanced, open skies type clauses, the agreement between Pakistan and the United States, rated 28 points according to the Index. The average ALI of Pakistan's bilateral agreements is 7.2, and this is largely supported by the granting of fifth freedom traffic rights, which in the vast majority of Pakistan's registered bilateral agreements is the only liberalized feature.

As a point of comparison, looking at two of the powerhouse States of Asian air transportation, Singapore and the United Arab Emirates; it is apparent that these States have succeeded in exchanging more liberal market access terms with partner countries than other countries. 68 air service agreements are registered with ICAO to which Singapore is a party. 30 of these have an ALI of 13 or higher, and five of these exceed 20 demonstrating advanced liberalization. The mean average liberalization index of registered agreements to which Singapore is party is 12.1. Furthermore, the MALIAT plurilateral agreement to which Singapore is a party is not included in these data. The United Arab Emirates has only 20 registered agreements. Seven of these agreements have an ALI of 13 or high, and 20 have ALIs above 20. The mean average ALI for the UAE'S registered bilateral agreements is 11.1.

Although the underlying data of this comparison may not be precise, there is a clearly demonstrated trend that the thriving Asian aviation hubs employ a significantly more liberal international regulatory framework than Pakistan.

2. Pakistan's most recent policy and key ASAs

Pakistan has adopted a limited open skies international aviation policy. Pakistan thus remains cautious of opening its skies on a unilateral basis, or even bilaterally, save with trading partners with which the government deems it advantageous to open up the aviation sector. Where Pakistan has more traditional ASA arrangements, it explicitly seeks to restrict the granting of fifth freedom rights only to those cases where it is not disadvantageous to Pakistan's international air carriers, however the national policy foresees that exceptions may be made for quality carriers.[31] This cautious approach to bilateralism is underpinned by the outcomes of previous flirtations with broad liberalization, such as when Karachi airport was unilaterally opened up to competition in 1992, which hurt Pakistani air carriers and most particularly the flag-bearing and 89% State-owned Pakistan International Airlines (PIA). Pakistan's unilateral open skies policy of 1992 did not work mainly because it allowed 7th freedom. As a result, dubious air carriers from African countries started operating between Karachi and Dubai. This policy could have been successful, had it been limited to 3rd/4th traffic rights, with strict safety oversight function of the CAA. The policy was rolled back only after one year of its implementation.

United States: Pakistan entered into a first liberal air services agreement with the United States in 1995. This was updated in April 1997, when Pakistan became the 34th State to sign on to the model United States open skies bilateral agreement. This came two weeks after the UAE completed a similar agreement with the US. The Pakistan-US agreement created a free market regime of pricing, capacity, designation and routes for the first five freedoms of the air. The sole airline to exploit these rights at the moment is Pakistan International Airlines, which operates to New York twice weekly as a beyond sector of flights to Manchester, UK, with fifth freedom traffic rights used between Manchester and New York. PIA was, at the time of signing the agreement, restrained from expanding service due to safety restrictions which have since been

[31] National Aviation Policy, supra note 7, S.6 (6).

lifted, thus whenever the market is favourable, PIA and any other upstart airline from Pakistan may fly to the United States directly or beyond any intermediate point with traffic rights subject to the approval of the third State. The open skies arrangement was extended further in April 1999, when the two countries agreed to allow unrestricted seventh freedom cargo operations, thus allowing US carriers to serve third countries from Pakistan on an operation which did not originate in the United States, and similar privileges for Pakistani airlines operating out of US airports. Some of the American Airlines like Delta Air and American Airlines are operating to Pakistan by having complementary type code share arrangements with third party code share arrangements like Gulf Air and Etihad Airways.

United Kingdom: Pakistan and the United Kingdom inked a significantly liberalized air service agreement in January 2008. The agreement provides for open skies on a point-to-point basis, thus third and fourth freedom operations are not restricted. Pakistani carriers may operate fifth freedom intermediate sectors without restriction, but Pakistani carriers are granted only six beyond flights per week and these may not operate via London Heathrow or Gatwick airports. Conversely, UK designated airlines have unrestricted beyond points from Pakistan, but may operate only six flights per week to Pakistan with intermediate stops benefiting from fifth freedom traffic rights. In line with European Community law, the UK may designate any European Union registered airline to operate the service. At the same time, Pakistan concluded a horizontal agreement with the European Union that allows the 18 European governments that have bilateral agreements with Pakistan to designate carriers to operate exchanged routes on the basis of substantial European Community ownership and majority control, rather than applying the national ownership and control provisions contained in the original texts of the agreements.[32] The horizontal agreement does not affect in any other way the grant of rights contained in the 18 bilateral agreements. The liberalized agreement with the United Kingdom has allowed multiple Pakistani airlines to serve regional as well as principal UK airports. Currently, Air Blue and PIA are using these rights and Shaheen International previously served Leeds and Bradford and had intended to introduce other UK services, although these appear suspended. British airlines, including BMI, had been expected to enter the UK-Pakistan market

[32] Bilateral Services Agreements brought into conformity since ECJ judgments on 5 November 2002. Online: European Commission, < http://ec.europa.eu/transport/air/international_aviation/doc/status_table.pdf>.

using the newly acquired rights, however the deterioration of the security situation in Pakistan from early 2008 halted plans and led to the withdrawal of service by British Airways.

United Arab Emirates: The UAE is by some margin the largest aviation partner for Pakistan, since Pakistan supplies over one million migrant workers to the UAE.[33] Moreover, the UAE is a primary transit hub for global traffic traveling to Pakistan. The UAE has been seeking open skies market access conditions into Pakistan since 2006. In the bilateral discussions between the two countries in January 2007, the amendments agreed placed restrictions on the number of services which Emirati airlines can operate into Pakistan. [34] These were divided according to originating airport, although this in effect individualized the rights granted to the three UAE airlines, as each operated out of a different hub. From Dubai, and thus by Emirates, UAE carriers had unrestricted access to Karachi, 5 flights per week to Islamabad, 4 flights per week to Lahore and 2 flights per week to Peshawar. From Abu Dhabi, and thus by Etihad, service have amounted to 14 flights to Karachi (with a total seat number restriction of 3668), 7 flights each to Islamabad and Lahore, and 7 flights to Lahore. From Sharjah, thus Air Arabia, 500 seats may be flown each week to Peshawar and 650 seats to Karachi. These were strict and limiting provisions which risk generating inflated prices due to the supply-demand curve distortion. Bilateral Air Services Agreement with UAE has been expanded in 2011, allowing Emirates Airlines daily flights to Lahore and Islamabad; weekly flights to Peshawar have been increased from two to three. Two weekly flights have been allowed, though not yet operational, to a new destination, Multan. Emirates will be the first foreign airline to commence scheduled services from Multan. Additionally, RAK Airways has been permitted to operate two weekly frequencies each to Lahore and Peshawar, and Flydubai has been allowed to increase its weekly frequencies from 7 to 11 for operations to Karachi.

India: The bilateral agreement in place between Pakistan and India remains a restrictive accord which amongst other limitations prevents the combined carriers of either country from

[33] The estimate number of Pakistani migrant workers in 2009 in UAE was 1.25million, online: UAE Interact <http://www.uaeinteract.com/docs/Expat_numbers_rise_rapidly_as_UAE_population_touches_6m/37883.htm>.

[34] Source: UAE Bilateral Negotiator, communication on file with author. UAE has responded with pressure tactics including denying landing rights for Pakistan International Airlines services, which are a prior granted under the bilateral agreement, online: Zee News < http://www.zeenews.com/news583895.html>.

exceeding a ceiling number of frequencies to the other country. However, significantly, these barriers were relaxed in 2008, when the two States agreed to more than double the reciprocal flight frequencies which went from 12 per week to 28 per week. Although in view of the population sizes of the two countries, this may appear to remain restrictive, it does allow considerable scope for service expansion. However, in 2009, a number of new services inaugurated by Pakistani carriers to India were suspended on commercial grounds. This was explained by low load factors resulting from difficulties in both countries to obtain travel entry documents to the other State. Pakistan must remain vigilant of the danger of curbing growth of international air transportation if it does not take initiatives to improve access to visitor visas and to seek to ensure the access of its own population to foreign entry documents.

V. INTERNATIONAL NON-COMMERCIAL REGULATORY FRAMEWORK

Safety and security are paramount concerns in international aviation. High profile incidents such as 9/11 which could in part be attributed to lax security levels, and safety-related cases such as the loss of AF447 en route to Paris from Rio de Janeiro reinforce the need for the highest level of oversight of safety and security in aviation due to the immense potential danger from aircraft, both to persons aboard and persons and property on the ground. This has resulted in the multiplication both of applicable norms and oversights to which international airlines are subjected. Most importantly, high profile audits are now carried out by ICAO, the EU and the US. Validation of each of these controls is critical to Pakistan and its airlines. No North American or European Union carrier presently serves Pakistan, hence the maintenance of direct connectivity between Pakistan and those regions is dependent on Pakistan and its airlines maintaining a satisfactory standing on inspection to continue service. Moreover, such is the profile of each of these audits; adverse findings in any of them could lead to protective measures being taken by third countries.

A. INTERNATIONAL CIVIL AVIATION ORGANIZATION

1. Safety

ICAO (International Civil Aviation Organization) is the United Nations agency for civil aviation. Its founding text, the above-described Chicago Convention, provides that the Organization may establish mandatory rules to be followed by signatory States,[35] albeit subject to the possibility to file a difference where compliance is impracticable.[36] Mandatory legal norms established by ICAO are known as Standards and are addressed to Member States. These Standards do not have direct effect and thus do not bind airlines of Member States.

Safety-related standards traverse many of the annexes to the Chicago Convention, including but not limited to Personnel Licensing (Annex 1), Rules of the Air (Annex 2), Airworthiness of Aircraft (Annex 8) and Aerodromes (Annex 14). Security-focused standards are grouped in Annex 17 under Aviation Security.

ICAO first commenced a voluntary-basis audit program of compliance with safety standards in 1994 due to concern about global implementation of the ICAO norms. In 1998, an Assembly Resolution made safety audits mandatory and the process became known as the Universal Safety Oversight Audit Programme. The safety audit process has shifted from being wholly confidential to fully transparent. Results of ICAO audits are now available to the general public through the Flight Safety Information Exchange on ICAO'S website.

ICAO audits only States as States alone are responsible for the implementation of the Standards into domestic law. Licensed carriers' compliance with the standards should then be supervised by the Civil Aviation Authority. ICAO audits do not include a scoring or validation component. Rather, auditors will bring any points of concern to the attention of the Member State, which has the opportunity to undertake corrective action before a follow-up audit assesses the State's response. The 2004 follow-up audit of Pakistan by ICAO was largely positive, with efforts to ensure increased compliance with Standards complimented.[37] However, this does indicate that there had been considerable deviance from the applicable norms. Furthermore, ICAO identified a significant safety concern upon its follow-up visit due to the ongoing failure of Pakistan to

[35] Chicago Convention, Art. 37

[36] Chicago Convention, Art. 38

[37] ICAO, Summary Report on the Safety Oversight Audit Follow-Up of the Civil Aviation Authority of Pakistan (Karachi, 20 to 25 February 2004), following up on ICAO, Universal Safety Oversight Audit Programme Audit Summary Report of the Civil Aviation Authority of Pakistan (Karachi, 12 to 20 June 2000).

survey its commercial air transport operators and their compliance with domestic regulations.[38]

This information is publicly available and States have access to detailed commentaries. Bilateral air transport agreements are typically imposed as a pre-condition of service that the ICAO Standards are applicable to. Thus, Pakistan is placing its air carriers' traffic rights at risk whenever it fails to implement all Standards contained in the Annexes to the Chicago Convention. In February 2011, Pakistan was audited under Universal Safety Oversight Audit Programme (USOAP). Pakistan was one of the top 10 countries in the world that scored maximum points. Thus, on account of safety, the situation seems to have improved substantially.

2. Security

9/11 proved the impetus for the Assembly of ICAO to extend the audit mandate granted to the Secretariat to security-related issues. A Ministerial Conference in 2002 approved the introduction of the mandatory Universal Security Audit Programme. This initially monitored only implementation of Annex 17 Standards related to security, however this was extended in 2007 to include relevant standards from Annex 9 on facilitation.

The transparency introduced with respect to safety audits could not be transposed to the field of security. Information on weaknesses in States' aviation security systems is far too sensitive and dangerous if in the hands of the wrong persons for reports to be placed in the public domain. However, the audits have assumed a limited degree of transparency with ICAO now revealing to Member States' through its secure website the level of implementation of the key components of aviation security oversight as recorded through audits.

Non-compliance with security-related standards can have even greater implications for international air services from Pakistan than breach of relevant safety standards. If safety standards are breached, these affect only domestic airlines, hence a State which is objected to a failure to implement safety standards would usually respond by suspending flights by Pakistani carriers. However, unsatisfactory security-related standards create a similar risk to the aircraft of both the home and partner State, thus failure to enforce security standards could result in flights being suspended both for the carriers of Pakistan and third countries. It is thus vital to the competitiveness and flourishing of the aviation sector that security-related standards are

[38] ICAO Follow Up Audit Report *Ibid* §3.4.

implemented at least as well as safety standards.

It should be underlined that Pakistan has taken note of the importance of ensuring compliance with ICAO standards, and listed improved oversight of the implementation of these norms as the first goal of the restructuring process of the Civil Aviation Authority, which commenced in 2006. Having taken advice from ICAO, Pakistan has been working to improve the regulatory oversight of the CAA, of which an important element has been ensuring the separation of the regulatory functions of the CAA from its service provider role. In 2011, the security aspect is being taken care of by the government directly through Airport Security Force (ASF). CAA Pakistan supports ASF by investments in the security-related infrastructure and equipment.

3. United States FAA Audits

The United States commenced safety audits of foreign States in 1991 by way of the International Aviation Safety Assessments (IASAs). These examined whether ICAO standards were being implemented. In 1994, the FAA modified the programme rendering the results public and introducing three categorizations of States according to their implementation of safety standards. Pakistan was initially listed as a Category II State, which meant that its safety oversight was deficient and therefore Pakistani carriers were prevented from expanding service either in terms of frequencies or aircraft size.

In 2000, the FAA revised the assessments, merging Categories II and III into a single non-compliant category. However, in December 2000 Pakistan was upgraded to Category I status, which it has since maintained. However, in view of the restrictions placed on Category II States' airlines to expand services and the public nature of the results of the IASA audits, it is critical that Pakistan maintains Category I status.

The United States has also audited security compliance on an airport basis since 1985. Wherever an airport is judged deficient, the United States may suspend all air traffic between the US and that airport and the results are also made public. Hence this further underscores the importance of adherence to ICAO security-based norms. The United States' security audits of Pakistani airports that serve US destinations are being carried out on a routine basis. Though the flights did not commence but in 2011, Lahore airport had been cleared for direct flights to USA.

4. European Union

In late 2005, the EU promulgated a Regulation[39] that provided for the introduction of safety audits. These differ from those operated by ICAO and the United States, as they are airline specific. Aircraft serving the European Union are inspected on ramp checks that verify whether both ICAO safety standards and EU safety norms are respected. Where an airline systematically demonstrates failure to respect relevant safety standards, it is placed in a blacklist of airlines denied the right to serve the EU.

In early 2007, Pakistan International Airlines was placed on the EU blacklist, however in a limited fashion, which permitted it to continue operations to the EU with only its Boeing 777 aircraft. This was later relaxed to permit service also by specific Boeing 747 aircraft and Airbus 310s. The airline was fully removed from the blacklist in November 2007, after demonstrating sustained improvements in respecting safety norms. However, this highlights that Pakistan's safety oversight tethers in a borderline zone, and the reprisals that may be taken are real and severe. Pakistan's aviation sector must be better regulated by the government if it is to flourish.

5. State Security

General levels of State security are also relevant in attracting new air services. Long haul services require airline crews and aircraft to stay in the destination country, and there will usually be some limited expatriate staffing overseas. In September 2008, following a bombing incident of the international Marriot-branded hotel, British Airways suspended its 6 weekly flights between London Heathrow and Islamabad, thus draining the UK to Pakistan market of a large portion of its capacity and represented the withdrawal of the last service by an European airline to Pakistan, following Lufthansa which had earlier made the decision based on commercial considerations. In October 2009, six foreign airlines (Emirates, Etihad, Qatar, Gulf Air, Air Arabia and Saudi Arabian Airlines) also all suspended services to Peshawar due to security concerns in that region, although contrary to the case of British Airways, each of these airlines has since promptly reinstated service. If the aviation sector is to attract the return of, or

[39] Regulation (EC) No 2111/2005 of the European Parliament and of the Council of 14 December 2005 on the establishment of a Community list of air carriers subject to an operating ban within the Community and on informing air transport passengers of the identity of the operating air carrier, and repealing Article 9 of Directive 2004/36/EC, [2005] O.J. L344/15. Implementation measures prescribed in Commission
Regulation (EC) No 474/2006 of 22 March 2006 establishing the Community list of air carriers which are subject to an operating ban within the Community referred to in Chapter II of Regulation (EC) No 2111/2005 of the European Parliament and of the Council [2006] O.J. L. 84/14.

increase service from international carriers, then State security must be improved to levels which assure airlines of the safety of their crew, passengers and aircraft while in Pakistan.

VI. GLOBAL COMMERCIAL FRAMEWORK

For the first half-century of modern civil aviation, airlines primarily functioned as independent entities. The deepest cooperation between airlines was typically an interline agreement, whereby a passenger could travel on one airline and switch to another on a single ticket, thereby receiving a partially integrated service that may allow his baggage to be checked from origin through to destination. Over the last twenty years, however, in the face of limitations on full-blown mergers posed both by national laws and by bilateral air services agreements, airlines have found ways to cooperate ever more profoundly. Various levels of integration of airlines will be examined with reference to the Pakistani context, both in terms of Pakistan's airlines and the foreign airlines serving Pakistan.

A. CODE-SHARING

In 1990, American Airlines and Qantas Airways initiated this business practice that has become quasi-ubiquitous in the global aviation sector. Code-sharing can be subdivided into two categories; parallel code-sharing and complementary code-sharing. Parallel code-sharing refers to two operators on the same route who share codes with the principal benefit of being able to offer a greater flight frequency, especially on routes that neither airline operates daily. Complementary code-sharing is more widespread, and is less immediately of concern with respect to competition. A partner airline places its own flight code onto the service of an operating carrier to a destination not served by the partner airline. Thus Qantas in 1990 was able to operate to interior US cities which it could never viably serve from Australia by placing a QF code onto AA operated flights out of its Los Angeles hub. Code-sharing has since spread and by 2004, already over 2000 agreements were in force between airlines.

Code-sharing can be socially beneficial for passengers. On parallel code-share flights, passengers have greater choice of return flights since the two flight legs need not be taken on the same operating carrier. Parallel code-sharing agreements usually result in schedule integration between the operating and partner carriers such that the partner carrier's feeder flight will arrive conveniently to allow connections onto the operating carrier's network. Code-sharing is also beneficial however to the airlines. Code-shared flights allow the service to appear as though a single airline were operating both legs. This prima facie convenience combined with the passenger benefit of schedule integration allows carriers in code-share agreements to increase their market share and yields.

Code-sharing in many instances requires some reciprocal norms to be established with respect to safety and service standards. Well-reputed airlines do not wish to risk their passengers' satisfaction by marketing under their code the services of another airline that does not match its safety or service levels. Delta and Air France suspended their code-share agreement with Korean Air in 1999 upon safety concerns, however the airlines assisted Korean Air in addressing its failings and the code-share arrangements were reinstated.[40]

Pakistani airlines have been very slow to adopt the global code-share phenomenon. Pakistan International Airlines has reiterated on several occasions the strategic importance of integrating into global alliances. Code-share agreements have been inked with Aerosvit Airlines, China Southern, Thai Airways and Turkish Airlines.[41] However, these arrangements are insufficient for PIA to compete with the global reach of rival airlines such as Emirates or Qatar Airways even before factoring in the benefit to these competitor airlines of their own code-share arrangements. Moreover, the most recent of these code-sharing agreements dates to 2007, demonstrating a lack of recent progress by PIA on this front. Pakistan's two other major airlines have no reported code-share agreements.

Many of the international airlines serving Pakistan benefit from code-share arrangements. Although the legs to Pakistan may not always be covered under the code-share arrangement, it does mean that international airlines are able to benefit from funneling traffic into their hubs at times convenient to transfer to destinations within Pakistan on flights sold under their code but operated by a third carrier.

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[40] Prof. Andreas Knoww, *Will Blacklists Enhance Airline Safety*, paper presented at Amsterdam Workshop on EU Liberalization, 29 June – 1 July 2006, online: German Aviation Research Society http://www.garsonline.de/Downloads/060629/KNORR%20 %20Blacklists%20GARS%20AMSTERDAM%20June%202006.pdf at 11. Air France in turn turned to Delta after losing an aircraft Flight 447 en route to Paris from Rio de Janeiro on 1 June 2009, online: Wall Street Journal < http://online.wsj.com/article/SB125303614325112753.html>.

[41] Profile of Pakistan International Airlines, Online: Center for Asia Pacific Aviation, <http://www.centreforaviation.com/profiles/airlines/pakistan-internationalairlines#dpage=5&npage=&spage=>.

Both Pakistan and its airlines must face the challenge of code-sharing. The government must seek to ensure that the bilateral framework does not impede Pakistani airlines from concluding code-share agreements. Many recent liberal bilateral agreements including the one in force between Pakistan and the United States expressly permit all code-share arrangements concluded by airlines subject to antitrust review. Pakistan's airlines should also be seeking to ensure they have global reach and offer convenient frequent services as far as possible by implementing both complementary and parallel code-share agreements with international airlines.

B. GLOBAL ALLIANCES

Global alliances take the code-share concept further, and strengthen the cooperation between airlines on a multilateral basis. There are now three major global alliances that dominate the international scheduled aviation market. Over 60% of passengers fly on an airline member of Star Alliance, Skyteam or Oneworld, and these earn almost 75% of the global revenue. Excluding low cost carriers, of the 25 largest airlines by revenue passenger kilometres (RPKs) in 2007, only Emirates, China Eastern and Virgin Atlantic have resisted joining one of the mega-alliances. Even more importantly for Pakistan, the alliances are now competing vigorously to cover as much of the globe as possible, thus they are now increasingly taking on smaller airlines. Air India and Vietnam Airlines are examples of airlines that were due to be subsumed into the Star and Skyteam alliances respectively in 2010.[42]

The Gulf carriers have to date bucked the alliance trend. Led by Emirates, by some distance the largest airline in the region, Saudi Arabian Airlines, Gulf Air, Qatar Airways and Etihad have all renounced joining a global airline grouping. The only Middle Eastern airline to have joined an alliance is Royal Jordanian. These major Gulf airlines however operate differently from Pakistan's airlines. They all operate out of a single domestic airport. They have focused on developing reputations as very high standard service providers and are specialized in transiting passengers. At Dubai Airport, more than 60% of traffic is in transit,[43] compared to a little over

[42] Air India's entry into Star Alliance in early 2010 has been pushed back due to problems associated to internal integration of technology since the merger with Indian Airlines, see online: Business Standard < http://www.business-standard.com/india/news/ai-may-again-defer-joining-star-alliance/393517/>. Vietnam Airlines is expected to complete its membership to Skyteam in June 2010, online: Skyteam news < http://www.skyteam.com/news/headlines/20100210.html>.

[43] Dubai Airport Leads the World in Growth, The National, 14 January 2010 online: The National, < http://www.thenational.ae/apps/pbcs.dll/article?AID=/20100114/BUSINESS/701139984/0/rss>, stating that two thirds of passengers at Dubai Airport are in transit.

half that percentage at London Heathrow airport.[44] The airlines in the Gulf region are also continuing to grow, even during the present economic downturn. During periods of internal growth, airlines are less pressed to align to protect their market shares than in mature markets. The Gulf carriers have also embraced code-share agreements to a far greater extent than Pakistani airlines.

Alliance partnership would help Pakistan International Airlines to attract a greater number of passengers on its international routes, as its passengers would be able to continue onwards on partner airlines from the international destinations served by PIA. This increased demand for PIA services would then allow more frequent service that is critical on long-haul routes. Less than daily service is a major disadvantage as passengers and most especially business passengers will be lured to airlines operating more frequently that better meet their precise schedules. Even on key routes such as London Heathrow – Karachi, PIA operates only three times per week, whereas for example Emirates operates 8 times daily between London and Dubai and has 4 daily connections to Karachi. Less than daily routing also deprives Pakistan of any significant international transit market. Although Pakistan is as well situated as the Middle East airports to capture a share of the global East-West transit market, it has not succeeded in doing so. The reasons for this are multifold and primarily economic, however an airline not focused on providing daily international services will struggle to develop market share.

C. FOREIGN INVESTMENT & MANAGEMENT CONTRACTS

Carriers have long invested in each other within limits allowed under domestic certification requirements. This has been a recurring trend with European carriers often investing in airlines in their former dependencies. Unilateral or reciprocal investment between carriers has often been used to confirm cooperative arrangements between two carriers, for example the tie up between Northwest and KLM in 1992.[45]

Foreign investment has on two occasions successfully been combined with management arrangements which have allowed mature airlines to export some of their expertise into partially

[44] British Airport Authorities note that 37.5% of passengers at Heathrow are in transit, online BAA Heathrowhttp://www.heathrowairport.com/portal/page/Heathrow^General^Our+business+and+community^Media+centre^Facts+and+figures/3cff846f3bba2010VgnVCM100000147e120a____/448c6a4c7f1b0010VgnVCM200000357e120a____/.

[45] Paul S. Dempsey & Laurence Gesell, Airline Management: Strategies for the 21st Century (Chandler: Coast Aire 2006) 657.

owned foreign carriers. In 1995 KLM purchased a 26% interest in Kenya Airways from the national government, in exchange KLM gained powers to name two Directors to the board, to propose candidates for senior management positions, and Kenya Airways could not make any major strategic decision including aircraft orders without approval from the KLM-named Directors.[46] In 1998 Emirates also signed a deal whereby it bought 44% of the Government of Sri Lanka's ownership of SriLankan Airlines. This investment was complimented by a contact which granted Emirates management responsibility of Sri Lankan. Although the arrangement was not renewed on its expiry in 2008, Emirates continues to own 44% of the airline while the government remains the majority shareholder at 51%.[47]

The two case studies demonstrate the benefits which a small or medium-sized flag bearing carrier can reap from very close affiliation with an established carrier. Both Kenya Airways and Sri Lankan Airlines are amongst the strongest and highest standard airlines in their respective regions of East Africa and West Asia.[48] Pakistan should note the benefits and advantages that can be gained from drawing experience and expertise from globally renowned airlines and consider the prospect of seeking foreign investment or foreign investment coupled with partial or full management powers for its national airline. The regulatory framework does not allow to establish an airline in Pakistan with 100% FDI component. The CAA Rule 179 (2) limits foreign ownership to maximum of 49%.

D. MERGERS

It is only most recently that cross border airline mergers have begun to emerge, previously domestic and international ownership regulations impeded this. Pakistani carriers may not presently be taken over by foreign entities due to the maximum foreign ownership regulatory cap of 49%.[49] Pakistani carriers would also have difficulty to buy any foreign airlines since

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[46] Kenya's Dutch Treat, Flight International 6 November 1996 online: Flight International < http://www.accessmylibrary.com/article-1G1-18899845/kenya-dutch-treat-kenya.html>. See further on the success online: International Finance Corporation - Infrastructure Advisory Success Stories < http://www.ifc.org/ifcext/psa.nsf/AttachmentsByTitle/PPPseries_KenyaAir/$FILE/SuccessStories_KenyaAir.pdf>.
[47] Sri Lankan Today, Online: Sri Lankan Airlines < http://www.srilankan.lk/aboutus/srilankantoday.shtml>.
[48] On success of Kenya Airways see Yaw A. Debrah & Oliver K. Toroitich, The Making of an African Success Story: The Privatization of Kenya Airways (2005), 47:2 Thunderbird Int'l Bus. Rev 205. Sri Lankan Airlines has a modern homogenous all Airbus fleet with an average age slightly under ten years composed of A320/A330 and A/340 aircraft. The airline has been recognized by Airbus as the most reliable small fleet operator of the A330 and A340 aircrafts. Sri Lankan has also on many occasions received awards for best service levels amongst airlines in Central/South Asian categories, and possesses a coveted Skytrax four star rating for service.
[49] See *supra* note 24.

similar regulatory limitations are in force around the world.

However, the proactivism of the European Union has facilitated mergers to take place within Europe, which is the epicenter of the recent shift away from national ownership. Although cross ownership of intra-European airlines had been unrestricted since 1997, it is only since the European Court of Justice declared on 5 November 2002 that national rather than European Community ownership clauses in bilateral agreements are illegal,[50] that the Commission has tackled external ownership restrictions and persuaded States to accept designation of airlines based on European ownership rather than State-specific national ownership requirements. This permitted a first major cross-border merger between Air France and KLM, which was inked in May 2004. Since then, Lufthansa first bought out Swiss International Airlines, and has since added Austrian, British Midland (BMI) and Brussels Airlines to its list of acquired airlines.

As the European market concentrates and provides the synergies and service rationalization resulting in lower costs and improved passenger welfare without a significant impact on competition, there will be increasing pressure in other regions for States to relax their regulations which impede mergers. Pakistan must stay abreast of such developments and remain vigilant of how it may respond in case of regional and global consolidation, including identifying potential partner airlines.

VII. ROUTE DIVISION AMONG MULTIPLE INTERNATIONAL CARRIERS

Through 2005, Pakistani regulations did not admit private airlines to serve international routes. This dissuaded the government from seeking multiple designation bilateral clauses, since only PIA among Pakistani airlines was authorized to serve international destinations under domestic law.

Designation policy has necessarily shifted since the change of legislation, however there is still strong bias in favour of designating the majority government-owned airline. No airline may operate internationally until it has served the domestic Pakistani market for at least one year.[51]

[50] European Court of Justice cases numbered: C-466-469/98, C-467/98, C468/98, C-469/98, C-472/98, C- 475/98, C-476/98 of 5 November 2002.

[51] National Aviation Policy, *supra* note 7, S.6 (5).

This is a significant barrier to entry as domestic markets are notoriously difficult to break even on.[52] Although the requirement is less stringent than the equivalent Indian rule examined above imposing a five-year service requirement, it remains a barrier and does create a competitive disadvantage for Pakistani upstart carriers since a number of competing foreign airlines operate exclusively on international routes. All routes being served by PIA are grandfathered to the national airline, moreover PIA is to have preference on all other available routes. Privately owned Pakistani airlines may only be designated to operate routes under a restrictive bilateral agreement where PIA has explicitly indicated that it has no intention of exploiting the route.[53] On the positive side, Pakistan does now actively seek multiple designations in its bilateral negotiations, and wherever open skies or multiple designations are incorporated into air service agreements, private sector airlines meeting entry requirements may serve any route allowing multiple designation, and they may provide service pursuant to traffic rights gained in negotiations by Pakistan but not utilized or not maximized by PIA.

The policies which continue to protect PIA create impediments for private initiative in the international market. Long-haul flights from Pakistan have significantly decreased as European airlines have withdrawn from Pakistan, and PIA has cut back on its service to the United States, which is an unrestricted market due to the open skies arrangement in place since 1997. Other than to protect the State-owned PIA, it is hard to comprehend why Pakistan would not be encouraging rather than impeding entry. We shall thus turn to consider how other States have dealt with the problem of electing carriers to operate restricted flight frequencies. This has in the past been a problem specific to a small number of States with more than one international scheduled airline such as the UK and the US. However, due to the acceptance by third States of the concept of Community carriers rather than State specific carriers within the EU, Member States are obliged to consider all EU airlines when designating air carriers. Despite continued

[52] The mandatory nature of certain routes in Pakistan's domestic market is demonstrative that they loss making. Recent examples in the international sphere of the difficulty for network carriers to be profitable on domestic or short-haul routes include the focus in Japan Airlines' bankruptcy proceedings on cutting domestic routes (http://news.bbc.co.uk/2/hi/business/10089208.stm), Thai International's jettisoning of a number of loss-making domestic routes (http://www.flightglobal.com/articles/2009/12/18/336367/thaitransfers-three-domestic-routes-to-nok-air.html), and Iberia spinning off its local operations (http://www.guardian.co.uk/business/2009/oct/22/iberia-european-revamp).

[53] National Aviation Policy, *supra* note 7, S.6 (4).

concentration in the US market,[54] there are still 5 trunk international airlines (United, American, Delta, Continental and US Air) which compete for operational rights to markets into which the FAA has thus far failed to establish open access.

A. UNITED STATES

The procedure for allocation of international routes by the Department of Transportation (DoT) is contained in the Code of Federal Regulations, *Title 14: Aeronautics and Space.* Air carriers are required to make written submission to the DoT for the award of any international operating rights. The application will be accompanied by economic data showing the benefits of the suggested route. Ordinarily, the DoT decision-maker will elect the carrier that will be designated to operate the allocated services. However, there are two alternative proceedings available. The decision-maker may choose to impose either an oral presentation by the parties, or require that an administrative law judge make a recommendation to the decision-maker on the outcome of the applications. The parties may also argue for either of these extraordinary procedures. A decision must be made within 90 days with a statement of reasons, a copy of which is transmitted to the President. Administrative law recourses are available. Wherever limited traffic rights are allocated, these are granted on a five-year basis that must be reviewed pursuant to 14. C.F.R. §399.120. This serves to encourage better service and lower fares as the risk of withdrawal of rights on a route a carrier has invested into is menacing.

The criteria that are used by the DoT in the United States for carrier selection proceedings include: Market structure (effect of route award to competition in overall market); Route integration (ability to connect traffic through the gateway and effect on economic viability); Proposed fares and service; Incumbency (incumbents benefit from a rebuttable favourable presumption); and Quick entrance. Outcomes of previous applications are not a factor in decision-making.

B. EUROPEAN UNION

Since under the terms of the Open Skies judgment of the European Court of Justice (5 November 2002), Member States may no longer conclude air service agreements that exclude potential designation of any Community carrier, all such airlines are eligible now to apply for

[54] In 2008 Delta subsumed Northwest making it the world's largest airlines, the consolidation continues as the 3rd and 4th largest airlines today United and Continental are in the early stages of a full merger (http://news.bbc.co.uk/2/hi/business/10095080.stm).

traffic rights gained by any EU government. Regulation 847/2004 mandates that Member States must distribute traffic rights among eligible Community air carriers on the basis of a non-discriminatory and transparent procedure.

The Regulations allows Member States to determine their own policies for allocation of limited traffic rights.[55] A number of frameworks have been mooted including first come first served; auction and lottery. However, as in the United States, the tendency has been to use the "beauty contest" method of distribution of limited rights.

In 2007, the United Kingdom introduced Regulations on the allocation of scarce capacity.[56] Factors for which the CAA must have regard are to include; proposed tariffs and the need for economical transportation; satisfaction of public demand; safety; effective provision of transportation to/from the UK; ability to compete with any incumbents; effects of existing services provided by carriers; and environmental factors.

In 2009, Germany filed its national procedure for the allocation of limited traffic rights with the European Union. Criteria identified by Germany in assessing the quality of applications for limited traffic rights include: service quality including whether service will be stopping or direct; reliability of operator; membership of alliance; promotion of market entry; environmental concerns; safeguarding public transport interests and existing designation.

C. UNITED ARAB EMIRATES

The UAE has a fast-growing air transportation sector, which although previously dominated by Emirates, has diversified with the founding in 2003 of the Abu Dhabi based national flag bearing Etihad Airways, and the Sharjah based Air Arabia. The UAE negotiates market access individually for is carriers which each operate out of different airport bases. This is represented in the UAE'S bilateral ASAs with Pakistan, where frequencies and seat numbers are individually allocated to each UAE carrier. Only on rare occasions, where limited frequencies are enforced by a bilateral agreement that does not specify the division of the rights, will the

[55] Regulation (EC) No 847/2004 OF THE European Parliament and of the Council of 29 April 2004 on the negotiation and implementation of air service agreements between Member States and third countries 2004 O.J. L. 195/3, Art. 5.

[56] The Civil Aviation (Allocation of Scarce Capacity) Regulations 2007, 2007 Statutory Instruments 3556, online: United Kingdom, Office of Public Sector Information http://www.opsi.gov.uk/si/si2007/pdf/uksi_20073556_en.pdf.

Federal UAE government intervene and determine the allocation of scarce traffic rights. This is done on a discretionary case-by-case basis. In the case of the bilateral relations with Canada, for example, it was natural to split the 6 allowed weekly frequencies equally between Emirates and Etihad, the only long range flying airlines, since the bilateral denies any operator to provide more than 50 per cent of the service.[57]

VIII. REGIONAL EXPERIENCES OF AVIATION LIBERALIZATION

This Section will seek to demonstrate how proactive States in the same geographic zone as Pakistan have liberalized their aviation policies, and the benefits that this has drawn. In view of the geographic proximity and the similar economic status, India provides a first important point of reference. Secondly we will examine the most liberal aviation States in Asia; the United Arab Emirates as the epitome of the rapidly developing aviation States of the Gulf, and Singapore.

A. INDIA

India, which shares an expansive border with Pakistan, is the world's second most populous country, with almost 1.2 billion people. Its civil aviation industry was for a long time entirely State-run. The first incursion into this was not until 1986 when private air taxis were allowed to ferry up to 10 persons, and free entry of private airlines was established only in 1997.

Access to international markets is still limited for Indian airlines by the fact that five years of domestic service is required before a foreign operating certificate is possible.[58] However the domestic aviation scene has been revitalized by low cost carriers spurred by foreign direct investment. The Indian aviation market was -prior to the global financial crisis -the fastest growing in the world, and in India the highest percentage of domestic traffic (around one half) in the world is carried on low cost carriers. The number is only expected to grow further. In addition to the population mass, Indian has progressively liberalized its nationality requirements, which today allow foreign investment up to 49% (however investment by foreign

[57] Centre for Asia Pacific Aviation, Canada, Australia, Emirates & Etihad: Case Study of Protectionism vs. Liberalism. who's got it right? online: <http://www.centreforaviation.com/news/2010/03/16/canada-australia-emirates--etihad-case-studyof-protectionism-vs-liberalism-whos-got-it-right/page1>.
[58] Guidelines for Operation of Indian Scheduled Carriers on International Routes SI. No. 2/2005 S. 3.4.

airlines is prohibited, but this is the next projected obstacle to be removed), and permit 100% ownership by non-resident Indians. Upstart Indian carriers have maximized the opportunity to gain foreign investment as BNP Paribas, Goldman Sachs and Dubai's government are investors in Spice Jet and HSBC has a stake in Jet Airways. Under pressure from entrant airlines, the Government of India approved a merger between the State-owned domestic carrier Indian Airlines and the State-owned flag-bearing international carrier Air India. This was done in order to rationalize and coordinate aircraft movements and generate cost-saving synergies.

India's international aviation policy remains limited open skies. An open skies agreement was finally concluded with the United States in 2005.[59] Generally, however, the Ministry of Civil Aviation is pursuing progressive liberalization, rather than immediate open skies policy. This agenda is however being vigorously implemented with 32 bilateral agreements having been relaxed in the period 1 July 2007 – 30 June 2008. The relaxation of restrictions on service to the United Kingdom pursuant to a Memorandum of Understanding in April 2005 resulted in a 300% increase of weekly direct services in a 2-year timeframe, a 60% increase of city-pairs served and a 17% decrease in economy passenger tariffs. Airlines of India serve 25 foreign countries, and have code-share agreements to serve 17 further States, underscoring the greater commercial integration of Indian carriers over their Pakistani counterparts. The Ministry of Civil Aviation has a policy of full transparency of its bilateral air service arrangements, publishing details of all agreements on its website, and seems set to embrace further liberalization and open skies as it is expected that India will be one of the next countries to sign on to the Statement of Policy Principles regarding the Implementation of Bilateral Air Service Agreements.[60] This Statement represented an endorsement of and plea for the raising of international barriers preventing air carriers from operating as they wish. Specifically the Statement calls for free market access, free access to capital markets, and free pricing.

B. UAE

The United Arab Emirates has emerged as the leader amongst a group of Gulf States that have been forcing the boundaries of aviation policy, and revising global travel patterns by offering new gateways to the world. From humble beginnings of single aircraft operations in 1985,

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[59] Air Transport Agreement between the Government of the United States and the Government of India, online: United States Department of State < http://www.state.gov/documents/organization/114739.pdf>.

[60] Statement of Giovanni Bisignani, CEO and DG of IATA, < http://www.euractiv.com/en/transport/eu-ussign-aviation-freedom-agenda/article-187409>.

Emirates – the airline of the Emirate of Dubai -is now the ninth largest airline in the world in Revenue Passenger Kilometres, and Etihad – the national airline of the UAE – continues its rapid growth at an annualized rate of 40% since it was founded in 2003. Although the UAE is a financial centre for the Middle East region, the growth of its aviation industry has been more reliant on transit traffic than origin and destination passengers. Over 60 per cent of passengers in Dubai airport are connecting, while a study of passengers between the UAE and the United Kingdom (Emirates' primary long haul destination) demonstrates that only 17% of Emirates traffic between the two countries is origin and destination traffic, with over 73% of passengers connecting in Dubai.[61]

Emirates has a double strategy for attracting transit traffic. The first is to employ high frequencies in its most important markets, the airline operates five daily services to London Heathrow (with 3 further daily services to London Gatwick), Delhi and Sydney. The flag carriers of those countries operate 3, 1 and 0 daily fights to Dubai respectively, underscoring the shallow origin and destination markets. High frequencies allow conveniently short transit times to leading global destinations. Moreover, Emirates has developed a second tier of destinations, especially in Europe, where it brings long-haul service to regional airports, which would usually require a connection in a European hub to reach any international destination. Such services include airports in Newcastle, Birmingham and Glasgow (UK), Nice (France), Hamburg (Germany) and Venice (Italy). Emirates has also a coherent fleet policy under which it operates exclusively widebody aircraft of limited types, which save significantly on maintenance, repair and overhaul costs. The development of the Emirates business model that has been adopted by Etihad and Qatar Airways has been dependent on three key factors:

Geography – The UAE has 3.5 billion people within an eight hour flight radius. This pivotal geographic point makes it an excellent connecting point to shuffle traffic especially between Asia and Europe, however with investment in advanced aircraft, all continents around the globe are now covered by Emirates. Karachi where Pakistan's leading airport is located is 700 miles and less than two hours flying time from the UAE, thus Pakistan is equally well placed to serve as an East-West interchange point.

Liberal Aviation Policy – The General Civil Aviation Authority (GCAA) of the UAE has had to

[61] Case Study on Regional Fifth Freedoms, United Kingdom Civil Aviation Authorities, online: < http://www.caa.co.uk/docs/589/Regionalfifths_casestudy1.pdf>.

push for liberal aviation agreements with third States so as to gain the traffic rights for Emirates. This will have entailed difficult negotiations in many countries due to the high dependency of the carrier on sixth freedom traffic.[62] The UAE has an open skies policy and thus seeks wherever possible to have a fully liberal operating framework, such as that in place with the United Kingdom and the United States. However, where Open Skies are resisted, the GCAA seeks flexible provisions especially with respect to capacity and frequencies with emphasis placed on growth rather than satisfaction of current demand. Thus, a new agreement signed with Australia in 2007 granted Emirates and Etihad sufficient increased market access to allow for projected growth for five years.[63]

As evidence of the UAE's pioneering liberal policy, at the November 2009 IATA Agenda for Freedom Summit, the GCAA joined six other governments and the European Commission in signing the "Statement of Policy Principles regarding the Implementation of Bilateral Air Service Agreements".

Capital – Access to capital due to the oil based local economy has permitted the exponential growth of Gulf airlines. While it may not be possible for Pakistan to replicate such conditions, it can help its carriers by allowing full access to foreign capital markets by removing restrictions requiring majority Pakistani ownership of airlines.

C. SINGAPORE

Singapore is a city State with a population below 5 million persons. In spite of this, its Changi Airport is the 22nd busiest in the world in passenger numbers, and can house more than double its current passenger numbers. The airport is dominated by Singapore Airlines, which continues to strengthen its position at the airport, however the airport is also used as a hub by a number of foreign airlines including Emirates, Etihad, British Airways and Qantas that benefit from the fifth freedom traffic rights exchanged with Singapore. The airport is moreover served by an array of low cost carriers operating internationally including Air Asia, Jetstar Asia, SilkAir and Tiger Airways.

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[62] Canada has for example typified reluctance to grant Emirati carriers broad market access citing lack of direct market see *supra* note 55.

[63] See Arabian Business <http://www.arabianbusiness.com/index.php?option=com_content&view=article&tmpl=print&id=10034>.

Singapore has developed as a key aviation hub by not only forging open skies links with countries, but also by forcing the multilateral agenda for liberalization. Singapore not only seeks traditional open skies agreements with third States, but it is pushing the boundaries of the traditional conception of open skies. Singapore was the first Asian country which concluded an open skies agreement with the United States in 1997, and in 2007 completed an open skies agreement with the United Kingdom that not only allows explicitly seventh freedom commercial passenger operations, but furthermore a memorandum of understanding between the Parties permits the carriage of cabotage traffic.[64] This underscores Singapore's commitment to bilateral liberalization that has been key to its development as an international aviation hub since the 1960s.

Singapore has also integrated into multilateral efforts to liberalize the aviation sector. Singapore is party (along with Brunei Darussalam, Chile, Cook Islands, Mongolia, New Zealand, Samoa, Tonga and the United States) to the Multilateral Agreement on the Liberalization of International Air Transportation. This Agreement is open to other States to join, and represents a multilateral establishment of inter-Member open skies. Moreover, by way of an additional Protocol, Singapore, New Zealand and Brunei Darussalam have extended the open skies regime to not only cover the first five freedoms of the air, but also to exchange seventh freedom and cabotage traffic rights. Singapore is also driving efforts to implement open skies amongst the Member States of ASEAN, which is projected to eventually establish an open aviation market comparable to that in operation in the European Union. In the absence of a single road path to achieving this open market, Singapore has concluded multilateral agreements with other ASEAN States establishing open skies. In 2003, an agreement was inked with Thailand and Brunei in 2004, and the Multilateral Agreement on the Full Liberalization of All Cargo Air Services concluded in 2004 with Brunei, Cambodia and Thailand, which permits seventh freedom and cabotage operations.[65] Finally, Singapore is also (along with the United States, Chile, Switzerland, UAE, Panama, Malaysia and the EU) a signatory of the earlier-mentioned "Statement of Policy Principles regarding the Implementation of Bilateral Air Service Agreements".

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[64] Agreement Between United Kingdom for Great Britain and Northern Ireland and the Government of the Republic of Singapore concerning Air Service 21 March 2007 G.B.T.S. No. 4 2008 (7362).

[65] Multilateral Agreement on the Full Liberalization of All Cargo Air Services, online: MALIAT, <http://www.maliat.govt.nz/agreement/englishtext.pdf>.

IX. LESSONS FROM INTERNATIONAL EXPERIENCES OF LIBERALIZATION

It is important to note that liberalization of air transportation does not come without its potential price. A fully market-driven industry can induce deterioration of other key factors including competition, safety and service levels. It is thus critical that responsible government entities survey airline behaviour in a deregulated sphere to ensure that they are operating in a manner consistent with public convenience and safety. We will first demonstrate that liberalization does not necessarily need to have consequences that are adverse to public interest, before underscoring that an independent and transparent administration with oversight responsibilities and enforcement mechanisms is key to the success of the deregulated market.

A. OVERSIGHT OF SAFETY AND COMPETITION IN DEREGULATED MARKETS:

1. Safety

Deregulation of aviation often carries with it a connotation of decreased safety. This can be attributed to widespread concerns in the early 1980s in the United States that safety standards had declined as a result of deregulation. Although actual fatal incidents remained in decline during that period, there was evidence of a decline in overall safety standards, and most importantly a decline in oversight. The FAA had been unable to respond to the increased number of operators and aircraft that led to an almost 70 per cent decline in the ratio of inspectors to aircraft. At that time safety concerns were system-wide. In the mid 1990s, a new wave of concern was expressed over safety levels in the United States of entrant carriers. It was believed that the presidential policy of promoting low cost air transportation came at the expense of fulfillment of the safety oversight mandate of the federal authorities. Criticism intensified after the loss of ValuJet flight 592 in 1996. The airline which temporarily lost its license to fly and subsequently re-branded as AirTran had been the subject of various reports for its poor safety record that was often linked to its outsourcing of maintenance operation, but no enforcement action had been taken by the FAA.[66]

India has also been the subject of criticism for poor safety records of its carriers, and a lack of

[66] See M Wilson, “Safety Concerns of Start-Up Airlines” 2:1 J. Air Transp. World Wide 38.

qualified personnel at the civil aviation authority.[67] This is unsurprising, given the exponential growth of the industry in India since its liberalization. However, the Directorate General of Civil Aviation has reacted by undertaking surprise spot checks and ensuring transparency of results with the publication of violations on its website. The results have revealed that safety deficiencies were apparent in incumbent as well as entrant airlines. The response of the DGCA facilitated the retention of Category I status upon its 2009 audit by the US FAA.

Deregulation does not, however, have to equate with decreased safety standards. Although econometric analysis does demonstrate an increase in number of safety-related incidents when an airline has a poor balance sheet, there is in fact a stronger causal relationship between standards of oversight and safety records. The largest low-cost operators in the world, Southwest, EasyJet and Ryanair, have never suffered a fatal safety incident, which is particularly remarkable given that these airlines fly frequently over short distances and the majority of safety incidents occur during the take off and landing cycles. Similarly, safety is not a concern associated with low cost airlines in the Asian Pacific region. It is particularly noteworthy that in many instances, it is the low-cost airlines which have the best balance sheets, and therefore if an association is to be made between finances and safety, then this would not militate against new entry. However, where an applicant entrant airline presents a questionable financial proposition, the analysis of whether finances may adversely affect airline safety will be a highly relevant issue in the assessment of whether a carrier is fit for certification.

In Europe high safety standards can be related to multi-layered and effective oversight. Under the cooperation fostered by the European Union, the Joint Aviation Authorities represented a collaboration of civil aviation authorities since 1970, and this has crystallized into the European Aviation Safety Agency, an agency of the European Union that implements and monitors aviation safety rules. The European experience of collaboration in aviation safety in a liberal aviation environment has led ASEAN to cite safety improvement and coordination as a key factor in its liberalization agenda.[68] Increasingly, in the era of "open-skies plus" aviation

[67] See ThaIndian News < http://www.thaindian.com/newsportal/business/india-upgrades-aviation-securitysafety-standards_100209563.html>.
[68] Alan J Tan, The ASEAN Multilateral Agreement on Air Services: En route to Open Skies: J. Air Transport Management 18 Feb. 2010 (Publication forthcoming).

agreements, States are undertaking to work together on matters relating to aviation safety.[69] The efficiency gains from such cooperation should allow enhanced oversight and improve safety records. Liberated of the hostile bilateral negotiation context, some governments are focusing their energies into the improvement of aviation safety, examples of such bilateral agreements include those concluded between the Commission of the European Union and the US and with Canada. Thus liberalization may now be perceived as facilitating improved collaborative and efficient safety oversight.

2. Competition

Another long-standing complaint about deregulation is that it can have anti-competitive effects. These concerns often stem again from the United States experience in which the "big bang" deregulatory model led to a number of allegedly anticompetitive practices that were not sanctioned. Chief amongst complaints was that incumbent airlines used their scale of operations to support predatory conduct against entrant airlines.[70] In particular, the network US airlines fiercely protected the hubs into which they consolidated operations, and through which they shuttled transit passengers. The airlines enjoyed great market power at their hubs, and in many cases monopolized direct routes out from the hubs that allowed them to charge a hub premium. Whenever a low-cost carrier sought to penetrate a lucrative over-priced direct passenger market, network carriers frequently responded by slashing their own prices and sandwiching the flights of the entrant airlines with two flights departing soon before and after the entrant. Furthermore, despite the rash of entrant airlines in the 1980s, many of these suffered bankruptcy and consolidation amongst other carriers led to claims that there was greater competition before deregulation.

Competition is necessary for a healthy aviation sector. Economic deregulation does not imply that the government should refrain from all intervention with respect to the industry. Rather, administrative action adopts an ex post facto review function that sanctions carrier practices, rather than predetermining these. It is important to note that international air transportation has inherently historically been non-competitive. In many instances, States had only one flag

[69] See EU Air Transport Agreements with United States [2007] O.J. L. 137/50, and with Canada, online: European Commission Air Transport Portal <http://ec.europa.eu/transport/air/international_aviation/country_index/doc/canada_final_text_agreement.pdf>.

[70] Paul S. Dempsey & Laurence Gesell, Airline Management: Strategies for the 21st Century (Chandler: Coast Aire 2006) 743 *et seq*.

bearing airline each, therefore the majority of international routes could only be served by a maximum of two carriers, and frequently when both carriers did operate these rights, bilateral agreements would either explicitly enforce pooling of revenues, or adopt other manners of preventing the airlines from competing, such as by restricting capacity or pre-determining fares to be charged. Moreover the shift towards global alliances, and government approval of carrier collusion through antitrust immunity demonstrate that States often believe that a more concentrated market for network aviation services is not inherently anticompetitive, and that the interests of competition may be better served by a smaller number of healthy competitors than a larger number of financially handicapped carriers.

The European market is illustrative of the potential benefits to competition of market liberalization. Whereas prior to the establishment of the common aviation market, scheduled air transportation was dominated by the network carriers, deregulation has facilitated the comfortable coexistence of trunk carriers and low cost carriers. The low cost carriers dominate point to point regional traffic movements and leisure markets, while the network carriers continue to offer services between major city hub airports that also act as feeder services into their longer haul networks. In many cases, network carriers have slashed their own tariffs and adopted other practices, such as offering one way fares that allow them to retain some of the discretionary intra-European travel market.

Furthermore, competition concerns can be addressed by legislating and enforcing a code that reprimands anticompetitive practices including collusion and predation, and controlling mergers such as to prevent these from being employed where this would violate public interest. Airline mergers have been subjected to antitrust scrutiny under domestic and -where applicable - European laws. Since 1992, airlines have been able in the United States and subsequently elsewhere to apply for preliminary approval of their cooperative arrangements with foreign airlines.

Where permission has not been granted for collusion amongst airlines, there have recently been the first cases of sanctions imposed against airlines. In 2006 Korean Airlines, Qantas and British Airways pled guilty to offences under S.1 of the Sherman Act in the United States that prohibits collusion between competitors.[71] The offences stemmed from the coordination of fuel

[71] See Dustin Appel, "Air Cargo Fuel Surcharges and Tacit Collusion under the Sherman Act: What Good is Catching a few Bad Guys if Consumers Still Get Robbed" (2008) 73 J. Air L. & Com. 375.

surcharges amongst carriers. The $300m fines levied against British Airways and Korean Air were then the second highest levies ever imposed against any corporations. Significantly, Virgin Atlantic and Lufthansa -that acted as whistleblowers on the collusion -escaped punishment under the Antitrust Division's Corporate Leniency Program.

As with respect to safety, recent bilateral agreements that have eliminated market access barriers have also stipulated that the contracting States would collaborate in the efforts to enforce antitrust policies. This coordination should ensure improved oversight of corporate activities and facilitate the burgeoning of competition in the liberal market.

In light of the increased importance of surveillance of firm conduct in a deregulated aviation sphere, the existing proactivism of the Competition Commission of Pakistan (CCP) is noteworthy. Two proceedings were brought against Pakistan Airlines by the CCP in 2009. In the first of these, decided in September 2009, the Commission found that PIA had abused its dominant position in the Pakistan-Saudi Arabia market by increasing fares by 80 to over 100% compared to the previous year during the Hajj religious pilgrimage period. The Commission moreover determined that the increased tariffs applied to pilgrims constituted illegal and unjustified price discrimination. The later proceedings of the CCP against PIA related to PIA's then industry-unique formula of calculating penalties for late ticket cancellations or changes as a percentage of ticket price paid. This differed from the industry standard of either charged a single fixed fee, or in some cases charging less or no change fee on tickets booked in more expensive fare classes. In this case, the CCP managed to come to an agreed disposition with PIA that did not impose any penalty, but pursuant to which the airline agreed to eliminate the percentage based differentiated change fee in favour of fixed sum penalties as of January 2010.

These developments demonstrate that the CCP is acutely aware of airline practices in the country, and is tracking which of these are anti-competitive. In a fully deregulated market, there is a high chance that the airlines will try an increased number of subtle techniques to dissuade entry, exercise their relative dominant positions, and generate revenue to offset decreased yields due to lessened market power. The CCP would not only have to maintain but also expand its ongoing vigilance of the operations in the sector.

B. ROLE OF PUBLIC ADMINISTRATION

As detailed above, the public interest concerns commonly associated with aviation liberalization can be addressed through effective supervision of airline activity by the administration. States now deregulating the industry furthermore have the benefit of hindsight of the outcomes in pioneering jurisdictions. However, requisite to the success of deregulation is the existence of independent and non-corrupt administrative agencies. The importance of independence was highlighted in the US at the time of the ValuJet incident, when it was claimed that the FAA had been failing its safety enforcement mission under the influence of the Presidential policy of promoting low cost air transportation.[72] Thus, it is essential that the administrative organs charged with overseeing aspects of airline conduct enjoy the freedom to fulfill their mandate without governmental interference.

Of concern also in Pakistan, however, could be the danger of public corruption. In order for deregulation to succeed, the oversight organs must operate effectively, free of abuse of power for private gain. The danger in a liberal market is that the operators would be able to bribe public officials so as to gain advantages such as certification or not to face sanctions for failure to respect legal and regulatory norms on safety, security, competition etc. According to Transparency International's annual Corruption Perceptions Index, Pakistan is ranked 139th out of 180 States for perceived corruption of public bodies.[73] The index indicates a growth of corruption in Pakistan since the beginning of the decade, although it has improved since its trough years of 2004 and 2005. Pakistan currently scores 2.4/10 on the Corruption Perceptions Index. On the contrary, the vast majority of advanced liberalization aviation States enjoy an extremely high ranking in the Index. The majority of the European Union States are clustered amongst the leading 30 ranked nations, with the major aviation States of UK, Germany, France and the Netherlands all particularly well placed. New Zealand and Singapore, which have fostered liberalization in the South East Asian and trans-Pacific zones, are ranked first and third on the index. Hong Kong, which is the other major liberal aviation State in East Asia, is ranked 12th amongst nations. Chile, which is the most liberal State in South America, is the highest ranked State of its continent on the Index, occupying the 25th rank globally. The major Middle Eastern hubs for international air transportation of Qatar and the UAE are well positioned as region-leaders at 22 and 30 in the index respectively, and the United States comes in at 19th on

[72] See ValuJet Flight 592 in Roger W. Cobb & David M. Primo The Plane Truth: Airline Crashes, the Media, and Transportation Policy (Washington D.C.: The Brookings Institution, 2003).
[73] Online: Transparency International <http://transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table>.

the list. Even Pakistan's close neighbour India is ranked in the upper half of the listing at 84th position.

This underlines that Pakistan faces a challenge of ensuring that its administrative organs operate free of corruption. The multi-layered international audit processes can help alleviate some of these concerns, since there will at least be some form of external verification that compliance is being ensured by domestic agencies charged with auditing safety and security standards. However, it is noteworthy that aviation liberalization has not been tested in a State where public corruption is perceived as a significant and pressing concern, and that close attention would have to be paid to the implications thereof if Pakistan were to embark on liberalization.

X. CONCLUSIONS AND RECOMMENDATIONS

Pakistan's international aviation sector is not as strong as it could, or arguably should be. Of three Pakistani international carriers, two are quasi-exclusively focused on the regional Gulf market. The flag-bearing Pakistan International Airlines remains over 89% government owned. It operates low frequencies to a high number of international destinations, and has shown little predisposition to integrating into the modern global commercial context by way of alliance membership or code-share agreements. On the large majority of its international routes, PIA faces no direct competition, yet the airline continues to amount deep losses. Improved connectivity would be positive for the local population and the broader Pakistani economy. It is thus important to establish a framework to generate growth in aviation, as has been enjoyed in other countries such as India.

Emphasis should be placed on the need to allow growth of existing and the entry of new Pakistani carriers. Capacity is lacking in the Pakistani aviation sector, and with the Gulf expanding seat capacity exponentially, and international carriers withdrawing from Pakistan, action is required otherwise Pakistan will end up representing a country-spoke of the Gulf networks. Fleet renewal is also key to PIA's economic performance, the current inhomogeneous fleet of about 40 aircraft has an average age of 13 years (compared with 5-6 years for Emirates and Singapore Airlines, and over half of the PIA fleet is older than 23 years. These aircraft hinder PIA, since they generate expenses due to inefficient energy usage and high maintenance, repair and overhaul (MRO) costs, and they are also less attractive to the flying public, and especially premium-paying passengers. The lack of capacity and the need for fleet regeneration can only be addressed by the promotion of policies attracting domestic investment and FDI into Pakistani airlines, one step is to cut and eventually eliminate all foreign ownership restrictions. Investigation should also be undertaken into how to ensure the flow of FDI into Pakistani airlines as effectively as it has reached upstart enterprises in India.

International air service into Pakistan by foreign carriers should be promoted. Key routes should be identified by study of the destination of transfer passengers connecting to Pakistan through the Gulf region. These should help identify areas where stand-alone service would be sustainable and reciprocal traffic rights should be exchanged with those territories. Daily service between international points should be targeted. Daily services are the only way Pakistani carriers will be able to compete effectively for passengers, and especially premium passengers, with the Gulf carriers who serve a multitude of destinations many on a multiple daily frequency basis. PIA's structure of serving many points weekly is inept to passenger needs and the orientation of the global business. As more frequent service to key destinations may necessitate reduction of destinations -at least in the short term – it will become essential for carriers to enter into cooperative arrangements with third country airlines to serve a greater number of destinations. As such, provisions on code-share and other airline cooperative arrangements should be prioritized in bilateral air service negotiations.

In order to safeguard the provision of international air services from and into Pakistan, it is essential that the country retains high-standing in the fields of safety and security. Audits, be they by ICAO, the United States, the European Union, or any other entity, must show compliance with international norms. Failure to comply therewith can lead to denial of service by foreign States by Pakistani carriers, or, where the security of all flights is compromised, the blacklisting of Pakistan as an aviation partner.

Key recommendations for government policy:

ISSUE	RECOMMENDATION
Discrimination between PIA and private airlines in attribution of international air transport market access.	Enactment of 2007 Draft Aviation Policy that foresees equality of private airlines with PIA in attribution of international traffic rights. In order to eliminate longer term discrimination in favour of PIA, which acts as a barrier to entry for private airlines, the Government should consider reducing and eventually divesting its investment in PIA.
Competitive distortion flowing from obligation of private airlines to pay penalty for non-provision of domestic socio-economic or tertiary routes to PIA.	Enactment of 2007 Draft Aviation Policy that eliminates this charge. Alternatively, any penalty should be payable to the Government of Pakistan. This could be used to subsidize domestic operations by the most efficient and reliable applicant in a transparent tender process, rather than this subsidy being channeled to PIA.
Minimal participation of PIA in code-sharing arrangements, non-participation of other Pakistani airlines in code-sharing, and non-membership of any Pakistani airline to global alliances.	Enactment of provisions that facilitate integration at the operational level of Pakistani and foreign airlines. This should include provisions in bilateral air service agreements permitting third country code-sharing operations. Operational integration with third country airlines should help boost yields for Pakistani airlines and fuel growth.
Restricted capital availability for Pakistani airlines limiting growth and fleet renewal.	Allowing upto 49% of FDI component has not worked so far for the scheduled airlines. Therefore, there is a need to review the possibility to further liberalize foreign investment in Pakistani airlines. Study should be undertaken as to whether Pakistan could effectively regulate and ensure compliance with local standards of airlines even if they were not majority owned and effectively controlled by Pakistani nationals.
Elimination of service to Pakistan by European airlines, reducing key trade and tourism routes.	Take measures to secure airport areas and protect the integrity of airplanes, personnel and visitors in the immediate vicinity of aerodromes. Allow expansion of services through Gulf hubs as best alternative to presently lacking frequent direct connectivity at least until a time when local or direct carriers are in a position to provide enhanced international services to and from Pakistan.

Efficiency of expertise on ancillary issues including competition, safety and environmental impacts of air transportation.	Inclusion of government cooperation clauses in bilateral air services agreements, foreseeing the exchange of information and collaboration with partner States on ancillary air transportation issues, in order to achieve coordinated best industry practices.
Need to protect international services through the maintenance of highest categorization in audits carried out by governments and ICAO, including post-liberalization.	Continued dedication to improving independent, transparent regulatory functions of the Civil Aviation Authority, with requisite government investment in personnel and training in this regard. Efforts to minimize or eliminate corruption.
Caution against anticompetitive practices in a deregulated aviation environment.	Ongoing proactive tracking of airline policies and practices by the Competition Commission of Pakistan. Increased vigilance of incumbent carrier practices in instances of new carrier entry.

ANNEXES

Air Liberalization Indexes of Registered Bilateral Air Service Agreements of Pakistan, Singapore and UAE.

Pakistan

Party	Date	Direct Services	ALI
UNITED KINGDOM	14/09/1999	Yes	14
OMAN	10/04/1976	Yes	0
THAILAND	27/05/1969	Yes	10
INDIA	16/07/1976	Yes	0
CHINA	29/08/1963	Yes	6
GERMANY	20/07/1960	Yes	6
CANADA	21/12/1960	Yes	6
UNITED STATES	10/04/1997	Yes	28
BAHRAIN	17/02/1975	Yes	0
ITALY	05/10/1957	Yes	8
SWEDEN	06/03/1958	Yes	8
FRANCE	31/07/1950	Yes	12
HONG KONG, CHINA	17/02/1998	Yes	12
SPAIN	19/06/1979	No	6
AFGHANISTAN	23/06/1957	Yes	8
NORWAY	05/03/1958	Yes	8
IRAN, ISLAMIC REP. OF	18/05/1957	Yes	14
DENMARK	09/11/1949	Yes	8
SRI LANKA	03/01/1949	Yes	8
TURKEY	02/11/1955	Yes	12
SINGAPORE	23/05/1975	Yes	14
NEPAL	24/08/1976	Yes	6
JAPAN	17/10/1961	Yes	0
NETHERLANDS	17/07/1952	Yes	6
SWITZERLAND	17/03/1952	No	8
KYRGYZ REPUBLIC	14/10/1993	Yes	0
EGYPT	13/12/1954	No	12
KENYA	18/02/1981	Yes	6
RUSSIAN FEDERATION	07/10/1963	Yes	6
AUSTRIA	28/05/1971	No	6
PHILIPPINES	16/07/1949	No	8

Party	Date	Direct Services	ALI Standard
BELGIUM	04/07/1958	No	6
PORTUGAL	07/06/1958	No	8
LEBANON	04/02/1964	No	10
UZBEKISTAN	16/02/1992	No	1
MAURITIUS	15/11/1979	No	6
BRUNEI DARUSSALAM	29/12/1987	No	6
POLAND	30/10/1970	No	6
MOROCCO	12/06/1974	No	6
ROMANIA	09/01/1973	No	6
ETHIOPIA	29/08/1952	No	8
SUDAN	23/02/1975	No	0
HUNGARY	11/05/1977	No	6
SERBIA AND MONTENEGRO	15/04/1976	No	6
MALTA	25/04/1975	No	6
ALGERIA	06/02/1976	No	6
IRAQ	20/06/1950	No	12
MALDIVES	04/11/1981	No	6
GHANA	27/11/1976	No	6
MYANMAR	03/08/1971	No	6
MACAO, CHINA	15/11/2000	No	14
KOREA, DEM. PEOPLE'S REP. OF	24/06/1975	No	6
NIGER	07/06/1977	No	6

Singapore

Party	Date	Direct Services	ALI Standard
INDONESIA	29/09/1994	Yes	16
THAILAND	02/09/1968	Yes	10
CHINA	21/04/1993	Yes	11
MALAYSIA	28/08/1972	Yes	14
HONG KONG, CHINA	30/04/1996	Yes	12
AUSTRALIA	03/11/1967	Yes	6
INDIA	23/01/1968	Yes	10
JAPAN	14/02/1967	Yes	14
UNITED KINGDOM	12/01/1971	Yes	14
PHILIPPINES	11/04/1974	Yes	10
KOREA, REPUBLIC OF	02/02/1972	Yes	14

UNITED STATES	08/04/1997	Yes	34
VIET NAM	20/04/1992	Yes	11
NEW ZEALAND	27/11/1997	Yes	44
GERMANY	19/06/1980	Yes	6
SRI LANKA	29/08/1985	Yes	14
FRANCE	29/06/1967	Yes	14
BANGLADESH	26/05/1979	Yes	10
BRUNEI DARUSSALAM	24/05/1997	Yes	34
NETHERLANDS	29/12/1966	Yes	14
SWITZERLAND	28/02/1969	Yes	10
MYANMAR	23/01/1996	Yes	10
CAMBODIA	04/11/1996	Yes	22
SOUTH AFRICA	22/05/1992	Yes	16
ITALY	28/06/1985	Yes	6
MALDIVES	12/08/1983	Yes	13
DENMARK	20/12/1966	Yes	10
TURKEY	14/01/1987	Yes	6
MACAO, CHINA	27/10/1995	Yes	18
GREECE	21/08/1971	Yes	6
AUSTRIA	08/08/1978	Yes	14
PAPUA NEW GUINEA	02/09/1980	Yes	10
IRELAND	20/02/1981	No	6
SPAIN	11/03/1992	No	7
MAURITIUS	24/02/1984	Yes	6
NEPAL	15/06/1984	Yes	17
SWEDEN	20/12/1966	No	10
BAHRAIN	12/12/1991	Yes	10
NORWAY	20/12/1966	No	10
FINLAND	19/01/1984	Yes	18
RUSSIAN FEDERATION	14/02/1969	Yes	10
PAKISTAN	23/05/1975	Yes	14
BELGIUM	29/05/1967	No	14
EGYPT	07/05/1980	Yes	8
SEYCHELLES	07/02/1984	Yes	10
ISRAEL	16/07/1970	No	14
CZECH REPUBLIC	07/09/1971	No	14
KUWAIT	16/02/1987	No	6
OMAN	18/04/1987	No	6
HUNGARY	09/03/1990	No	6

Party	Date	Direct Services	ALI Standard
ROMANIA	11/01/1978	No	10
CYPRUS	27/01/1989	No	0
BULGARIA	28/11/1969	No	14
KENYA	17/08/1987	No	6
MEXICO	21/06/1990	No	10
JORDAN	07/08/1985	No	10
LATVIA	06/10/1999	No	16
LUXEMBOURG	09/04/1975	No	10
LEBANON	30/03/1968	No	10
SERBIA AND MONTENEGRO	10/12/1971	No	14
ARGENTINA	20/02/1997	No	13
MALTA	19/07/1983	No	6
TANZANIA	10/12/1987	No	0
CHILE	09/12/1980	No	24
LAO PEOPLE'S DEM. REP.	24/04/1995	No	18
MONGOLIA	18/05/1993	No	16
NAURU	29/04/1980	No	10
IRAQ	03/07/1975	No	10

UAE

Party	Date	Direct Services	ALI
UNITED KINGDOM	20/06/1972	Yes	14
SAUDI ARABIA	25/09/1991	Yes	10
GERMANY	02/03/1994	Yes	7
SYRIAN ARAB REPUBLIC	27/12/1989	Yes	5
UNITED STATES	13/04/1999	Yes	34
THAILAND	20/03/1990	Yes	10
CHINA	14/09/1989	Yes	4
FRANCE	09/09/1991	Yes	4
RUSSIAN FEDERATION	23/06/1987	Yes	5
MALAYSIA	04/05/1993	Yes	10
ITALY	03/04/1991	Yes	4
SWITZERLAND	13/03/1989	Yes	10

SOUTH AFRICA	03/02/2001	Yes	16
HONG KONG, CHINA	29/04/1998	Yes	16
NETHERLANDS	31/07/1990	Yes	14
MOROCCO	26/02/1987	Yes	4
CYPRUS	07/12/1999	Yes	4
CZECH REPUBLIC	15/12/2002	Yes	27
NEW ZEALAND	01/03/1998	Yes	14
BRUNEI DARUSSALAM	29/03/1993	Yes	10