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COMMUNICATION FROM THE COMMISSION

Developing a Community civil aviation policy towards the Republic of India

1. INTRODUCTION AND SUMMARY

- 1.1 The Republic of India, the world's largest democracy and second most populous nation, is undergoing rapid change and is emerging as an important economic power in Asia. After some decades of pursuing its own economic and political path, India is increasingly opening up and actively engaging on the world stage.

Today, India is one of the six fastest growing economies in the world. India represents a vibrant and rapidly growing consumer market with a fast increasing middle-class already exceeding 250 million inhabitants. Economic forecasts for India all point to a continued high level of GDP growth. While India achieved an annual economic growth rate averaging 6% during the 1990s, it is currently poised to grow even faster at an impressive 8% and above in the coming years.

- 1.2 The Indian economy has clearly benefited from the market-oriented policies pursued since the 1990s and reinforced under the current government. India is developing as a key global centre for outsourcing for many manufacturing industries and service companies and Indian industries are becoming internationally competitive.

The EU and India already enjoy a close relationship based on shared values and goals. Representing nearly one fourth of India's total trade, the EU is India's largest trading partner and also its main source of foreign direct investment (FDI).

- 1.3 Demand for air transport in India is increasing rapidly both for corporate business travel, international tourism (both foreign visitors and different Indian ethnic communities living abroad) and domestic travel.

The Indian air traffic market is currently among the fastest growing in the world. In 2004, air traffic in India was reported to have increased by some 25%. With such a rapid development in air traffic, serious bottlenecks are occurring in the air transport infrastructure both in terms of airport capacity and aircrafts available.

- 1.4 Market opening and attempts to attract private and foreign capital to the Indian aviation market are seen as part of the measures necessary to develop and modernise India's aviation sector in order to meet increasing demand and consumer expectations. While the Indian aviation sector has long been characterised by a restrictive approach with limited access and strong state control, India has in recent years taken decisive steps towards a more open and competitive aviation market.

Due to its extraordinary growth rates and gradual market opening, India offers new business opportunities and a strong potential also for growth for European airlines, aircraft manufacturers and service providers.

- 1.5 As a consequence of the "open skies" judgements of the European Court of Justice on 5 November 2002, the 22 bilateral agreements between Member States and India are unsustainable and need to be amended. The Commission has been given a "horizontal" mandate to negotiate with third countries such necessary corrections to bilateral agreements.

However, in view of (i) the growing importance of the Indian aviation market, (ii) the difficulties encountered by individual Member States in seeking to bring bilateral agreements into conformity with Community law even in negotiations where the Indian authorities have requested and obtained significant additional traffic rights and (iii) the overall legal and economic benefits of replacing the fragmented European approach in its relations with India with a comprehensive, co-ordinated and liberal approach, the Commission is of the view that it is now appropriate to develop a wider range of opportunities between India and the Community in air transport.

This is why India was identified in the Commission's Communication "*Developing the agenda for the Community's external aviation policy*"¹ as a key target country for a Community-wide agreement. Also the Association of European Airlines (AEA) has identified India as a particularly important market in relation to which a comprehensive Community agreement could be justified².

In its Conclusions on external aviation relations, the Council has explicitly taken note of India as a potential candidate for a future request for comprehensive negotiating mandates.³

- 1.6 In India's response in August 2004 to the European Commission's Communication entitled "An EU-India Strategic Partnership"⁴, India has expressed its readiness to consider a comprehensive air transport agreement with the EU.

With this Communication, the Commission therefore recommends that the Council authorises the Commission to negotiate, on behalf of the European Community, a comprehensive agreement on an Open Aviation Area with India combining market opening with a parallel process of regulatory co-operation and/or convergence notably in priority areas such as aviation safety, security, environmental protection, research and technology and application of competition rules ensuring a level playing field and fair and equal conditions for competition.

Positive exploratory contacts between the Ministry of Civil Aviation of India and the services of the European Commission have been made during the first half of 2005, which may serve as a good basis for entering into formal negotiations with India.

2. THE GROWING IMPORTANCE OF EU-INDIA POLITICAL AND ECONOMIC RELATIONS

- 2.1 In recent years, the Indian economy has performed impressively well with economic growth rates averaging 6% during the 1990s. In 2003, GDP growth in India reached 8.6%.

¹ COM(2005) 79 final, dated 11.3.2005

² "*Future developments in international air transport to and from the EU: An AEA perspective*", October 2004

³ Council Conclusions of 27 June 2005 on developing the agenda for the Community's external aviation policy.

⁴ COM(2004) 430 final, dated 16.6.2004

Representing nearly one fourth of India's total trade, the EU is India's largest trading partner and also its main source of foreign direct investment.

EU-India trade grew by 34% between 2003 and 2004 alone. However, India is only the EU's 12th largest trading partner, behind countries such as Taiwan and Korea. The EU's trade with China in 2004, for example, was more than five times bigger than trade with India and the EU's FDI in China was more than 10 times the amount of FDI in India.

These figures demonstrate the extent of the still untapped potential for economic growth, trade and investment activity in India.

- 2.2 With its nearly 1.1 billion population, impressive economic growth rates and immense potential in general, India's political status in the world is becoming increasingly significant. Intensity in EU-India relations has increased in recent years and EU-India summits have been held on an annual basis since 2000.

In the Commission's June 2004 Communication on "An EU-India Strategic Partnership", the Commission proposed to further strengthen the political and strategic dimensions of EU-India relations. The Commission proposed a number of strategic sectoral dialogues aimed at strengthening the economic partnership between the EU and India including a proposal for enhancing co-operation on air transport, through the initiation of a dialogue on civil aviation and negotiation of an EU-India air transport agreement.

India's response of 27 August 2004 to the Commission's Communication was positive. India highlighted its efforts aimed at attracting foreign direct investment in the Indian aviation sector and at improving efficiency of airport infrastructure. India also expressed its readiness to consider a comprehensive agreement with the EU on air transport including in the areas of market access, regulation and air traffic management.

- 2.3 At the 5th India-EU Summit held on November 2004 in The Hague, India and the EU agreed to jointly elaborate a comprehensive EU-India Action Plan for implementing the strategic partnership. This Action Plan is currently under preparation.

3. INDIA'S GROWING IMPORTANCE IN INTERNATIONAL AVIATION – A MARKET PROFILE

India - an aviation market in rapid growth and transformation

- 3.1 After a decade with more moderate growth rates averaging 5% per annum, the domestic aviation market in India is booming as a result of high GDP growth, general higher income, a growing urban middle class representing an important potential for tourist travelling, emergence of new entrants including low-cost carriers and falling fares. In most recent years the Indian air traffic market has been among the fastest growing in the world. In 2004, air traffic in India was reported to have increased by some 25%.

Since 1990, the number of seats available on scheduled non-stop flights between the EU and India has increased from 2.6 to 4.4 million in 2004 (+70%).⁵ As a result of recently agreed increases in traffic rights, frequencies and available seats are expected to grow even faster in the coming few years as the new traffic rights are being implemented in the market.

- 3.2 Within the recent few years a significant number of new routes have been opened to destinations such as Bangalore, Hyderabad, Amritsar, Chennai and Cochin.

Seven EU carriers currently fly passengers to India on scheduled routes while currently two Indian carriers (Air India and most recently Jet Airways) fly to Europe. In addition, two US carriers carry passengers via Europe to India and back. A total of 17 city pair routes are now operated between India and the EU. The largest share of the non-stop scheduled traffic between the EU and India is with Germany with 32% of the total traffic followed by the UK (31%), France (18%) and The Netherlands (9%).

Of a total number of weekly frequencies between the EU and India of 130 in winter 2004/2005, Lufthansa and Air India each had a share of 22% while British Airways had a share of 15%.

Looking forward

- 3.3 Future growth rates in Indian air passenger traffic are expected to remain impressive in the coming years. The International Air Transport Association, IATA, forecasts an average annual growth of 7.8% in international passenger traffic to India over the period 2004-2008. IATA predicts the Indian cargo market to increase even faster with an annual average growth of 8.4% up to 2008.

The Centre for Asia Pacific Aviation forecasts total air traffic in India to rise by five million passengers each year over the next ten years and that India's domestic and international markets for the calendar year 2004 would increase by up to 30% to around 20 million passengers each.

India's total passenger traffic is expected to increase from approx. 44 million passengers in 2004 to 58 million passengers in 2014.⁶ In its 2004-2023 Global Market Forecast, Airbus is forecasting an average annual growth rate of 6.5% in the Western Europe-Indian Sub-continent market over the coming two decades.

Key market drivers

- 3.4 Historically, the Indian government has paid limited interest and prioritisation to tourism policy.

However, one of the key drivers in recent international air traffic to and from India has been tourism. The "Incredible India" campaign launched by the Ministry of Tourism in 2002 has been widely heralded as a major success. In 2004, India received 3.4 million foreign visitors, up 23.5% from 2003. Arrivals in 2005 are

⁵ Source: OAG schedules

⁶ "Asia/Pacific Air Traffic – Growth and Constraints", Air Transport Action Group (ATAG), 2001

expected to surge by up to 30% and the Ministry of Tourism has established a target of 40 million foreign tourists visiting India by 2020.

Also Indian outbound tourism is increasing rapidly and in 2003 soared by some 30% to approx. 4.5 million.

- 3.5 Another expected key driver in future demand for air transport in India is fares. In real terms, international fares have progressively fallen over the past two decades. Such decreases in fares, however, do not appear to have fully materialised in relation to India as capacity constraints have driven fares to and from India up relative to comparable competing destinations in the region. At present, the gap between Indian fare levels and competing destinations is reported to be significant. For example, it has been reported that a flight to India from Britain or the United States is typically around 40% more expensive than a flight to competing destinations such as Thailand or Indonesia.

In this context, it is worth noting that following the early 2005 “open skies” agreement between the US and India, industry analysts expected considerably lower prices to follow from the new agreement. One source expected a 20-30% drop in air fares while another expected current air fare levels of 1,000-1,500 USD to come down to around 700 USD over the next 12-18 months as a result of more supply and competition.

Allowing private Indian carriers to operate international routes will increase the competitive pressures faced by incumbent carriers. The emergence of new-comers and low-cost carriers on the domestic Indian market is expected to have the same effect within India.

4. KEY TRENDS IN INDIA’S CIVIL AVIATION POLICY

General policy

- 4.1 India’s civil aviation sector is undergoing a rapid transformation these years. In 1990, the Indian government launched a programme of economic liberalisation of air transport services which resulted, *inter alia*, in (i) the announcement of a cargo “open skies” policy for international flights; (ii) the permission of non-state owned airlines to enter the Indian market; and (iii) gradual liberalisation of bilateral air services agreements with third countries.
- 4.2 The Indian government increasingly recognises that the aviation sector can be a catalyst of general economic development and in 2003 therefore set up a Committee, led by former cabinet secretary Naresh Chandra, to draw up a Road Map as a basis for a new national policy for civil aviation. It appears that the current Indian government continues to employ key recommendations of the Committee of developing a more open and competitive aviation market in India.

The report of the Naresh Chandra Committee declared that an integrated approach to civil aviation is required, one which is based on the following “four fundamental pillars”:

- the introduction of a level playing field for all operators;
- increasing private participation and competition by reducing barriers to entry;
- adherence to stringent safety standards as well as sound regulatory oversight of the air transport market;
- transparent institutional mechanisms which provide for socially desirable but uneconomical services.

4.3 The Committee's investigation led to the identification of several overall conclusions including the following:

- As an immediate priority it looked for a more liberal fiscal regime which would include a reduction of fuel taxes. The government is yet to adopt its recommendations in this respect.
- The committee deemed that airport charges were too high and should be lowered and that the supply of aviation fuel should be liberalised to allow additional suppliers at airports.
- The Committees' advocacy of the elimination of route dispersal rules seems to have been taken up by the government in June 2004 thereby changing the old system of mandatory route mix of all operators of routes between major cities and "thin" marginal routes to a new system with a levy on private operators allowing funding of uneconomical routes (public service obligations).
- Similarly, the suggestion that foreign equity investment (except from foreign airlines) should be permitted for up to 49% of airlines has been acted upon.

Market opening and new entrants

4.4 At the end of 2004, the Indian government decided to allow privately owned carriers fulfilling certain criteria (i.e. having a fleet of at least 20 aircrafts and more than five years of operating experience) to operate on international routes. Two carriers (Jet Airways and Air Sahara) already qualify for this and have recently been granted rights from the Indian government to fly to international destinations.

The number of airlines providing services on the domestic market is rapidly increasing. There are currently seven scheduled registered airlines in India: (1) the state-owned Air India; (2) Indian Airlines; (3) Alliance Air (subsidiary of Indian Airlines); (4) Air Sahara; (5) Jet Airways (privately owned); (6) Air Deccan (privately owned low-cost carrier); and (7) Blue Dart Cargo (specialised cargo carrier).

In 2005 alone, an additional five carriers are expected to enter the Indian market (SpiceJet; Kingfisher Airlines; Air India Express; Indus Airways and Go Air).

4.5 The Indian government is also continuing its policy of further liberalisation of bilateral air services agreements. In December 2004, the Indian government decided to discontinue the practice of seeking compensation under mandatory commercial agreements between designated companies for imbalances in use of traffic rights. No new air services agreements will include such mandatory commercial agreements

and existing mandatory compensation agreements will be phased out after a maximum of five years.

- 4.6 As a significant result of the government's increasingly liberal aviation policy, India and the US signed a bilateral "open skies" agreement in April 2005. The agreement removes all limitations on capacity and controls on competitive pricing. The designation provisions also remove all quantitative controls on market entry while, however, retaining classical ownership and control restrictions. In addition to completely deregulating capacity and access in 3rd, 4th, and 5th freedom markets, the new agreement also provides for unrestricted 7th freedom all-cargo services. The new agreement is also expected to facilitate the development of new service patterns that would allow cross-polar non-stop services between the US and India that have not hitherto existed. This will depend on obtaining efficient overflight access to Russian airspace.

India has also agreed significant increases in traffic rights in recent bilateral agreements with a number of other countries including notably the UK and China.

Infrastructure bottlenecks

- 4.7 With the recent extremely high growth rates in demand for air transport in India, serious bottlenecks are occurring in the Indian aviation infrastructure notably in terms of airports and aircrafts available. Available airport capacities and services are inadequate with constraints both in terms of runway capacity, parking space and terminal capacities.

The Indian Government is seeking to attract private capital into new partnerships. New green-field airports are being built in Bangalore and Hyderabad. The government is selecting strategic partners to become shareholders in the airports of Mumbai and New Delhi. In March 2005, the Indian Government invited financial bids from nine pre-qualified bidders. A number of established European airport operators are included in the pre-qualified consortia.

The planned partial privatisation of Air India and Indian Airlines has not yet succeeded which has hampered modernisation and expansion of their fleets on a commercial basis by private capital. The government therefore appears to have decided to reinforce these airlines and provide sovereign guarantees for purchase of aircrafts.

In order to meet the growing demand for air transport services in India, massive investments in air transport infrastructure are required both in airports, aircrafts, air traffic management technology and supporting facilities. The Indian Ministry of Civil Aviation expects, for example, that in the next few years nearly €8bn needs to be invested in Indian airports.

In December 2004, it was reported that 10 completely new airports were being planned while modernisation of another 15 airports was foreseen (in addition to modernisation of the four main airports of Delhi, Mumbai, Calcutta and Chennai).

Remaining challenges in modernising India's aviation market

- 4.8 The Indian government appears determined in implementing a coherent and market-driven aviation policy based on competition and equal treatment. This is very encouraging. The policy of the Indian government continues, however, to be criticised domestically for (i) a lack of sufficient transparency at the policy level; (ii) slow decision-making and implementation processes; (iii) absence of effective competition law; (iv) absence of an environment conducive to private investment; and (v) restrictions on direct foreign investment.

These concerns may be reflected in an announced government policy White Paper that is expected to be published shortly.

Technical co-operation

- 4.9 The rapid increase in demand for air transport also poses significant technological challenges in relation to safety, security and air traffic management aspects. In this context, the EU co-financed "EU-India Civil Aviation Co-operation Project" is being seen by the Indian government as a very valuable project. The project started in 2001 with a currently foreseen duration until end-2006 with a total EU grant of 18 million € in Community funding. Both Indian authorities and industry as well as European industry have expressed a strong interest in a continuation on a longer-term basis of this project or similar co-operation structures.

5. CONCLUSIONS: SUBSTANTIAL ADDED VALUE OF A FUTURE EU-INDIA AIR TRANSPORT AGREEMENT

- 5.1 Since the 1940s, EU-India relations in civil aviation have been based on bilateral air services agreements between individual Member States and India with little, if any, coordination at Community level. 22 out of the 25 EU Member States have bilateral air services agreements with India (all except the three Baltic states). Most of these bilateral agreements are based on single or dual (or in a few cases more) designation at Member State level of national carriers which are allowed to operate on routes to India. Moreover, traffic rights allowed under the bilateral agreements are also limited hence restricting the scope for competition.

Following the judgements of the European Court of Justice on 5 November 2002, existing bilateral air services agreements based on national designation urgently need to be amended to restore legal certainty by including Community designation clauses permitting designation of any Community air carrier established in a Member State.

- 5.2 The conduct and outcome of bilateral negotiations in recent months between Member States and India have not yet led to the necessary alignment of existing agreements with Community law. As a result, bilateral agreements with India remain vulnerable to legal challenge.
- 5.3 However, the Commission's use of the horizontal mandate in the course of 2005 has proven efficient in rendering more than 250 bilateral agreements compatible with Community law. While India in recent bilateral negotiations with Member States has not been able to immediately accept Community designation, India has committed

itself to address this issue with the European Commission in the context of a possible future horizontal agreement. Exploratory talks have been held with India in recent months in this respect and progress has been made.

Benefits and added value of a Community approach

- 5.4 As the EU has developed a strong Community dimension of its internal aviation market it would be logical and coherent to pursue this dimension also in the EU's external relations. Moreover, the experiences which the EU has gained in this respect represent useful references for many third countries.
- 5.5 There would be significant economic benefits from an EU-India Open Aviation Area. A recent study commissioned by the European Commission has made an indicative assessment of the potential longer-term economic benefits for both sides involved in a fully liberalised EU-India aviation market, which could be in the order of 200 million € per year. It is important that negotiations on a possible comprehensive agreement are conducted in a spirit which seeks to deliver mutually beneficial outcomes.

Gradual market opening accompanied by regulatory convergence

- 5.6 Obviously, it will be of paramount importance to ensure that opening and integration of markets is undertaken in a balanced manner that takes into account other important policy objectives and mitigates potential adverse impacts.

It is therefore important to ensure that the process of market opening is accompanied by a parallel process of regulatory co-operation and/or gradual convergence with regard to safety, security, environmental and competition law aspects thereby ensuring a level playing field and fair competition based on equal opportunities.

The way forward

- 5.7 As this Communication has shown, India has embarked on profound changes in its civil aviation sector based on gradual market reform and opening.

Significant efforts will continue to be necessary for the development of the Indian air traffic sector to match the rapidly growing demand and increasing expectations by the users. Closer co-operation between the EU and India would be mutually beneficial, offer significant new opportunities both for India and the EU and would be able to contribute to ensuring an efficient and safe aviation sector.

Efforts should therefore now be made for air transport to become a key area of closer co-operation between the EU and India thus contributing to the Strategic Partnership between India and the EU. The Commission therefore considers it important to offer India a comprehensive scope for strengthened co-operation in civil aviation.

Such co-operation must, as first step, address and resolve the legal issues in relation to existing bilateral agreements between India and Member States.

- 5.8 However, an agreement with India should not be limited to agreeing on Community designation clauses. It should go further and establish an ambitious framework integrating wider aviation issues such as regulatory co-operation in the fields of

aviation safety, security, air traffic management, technology and research as well as “doing-business” issues and industrial co-operation. With respect to environmental issues, the agreement must be consistent with the EU’s commitment to sustainable development. Apart from the economic benefits highlighted above, the expected growth in air traffic has also unwanted side-effects, notably on air quality and noise levels around airports and through the contribution to global climate change. It is important that the agreement does not restrict the EU’s ability to apply regulatory or economic instruments to mitigate these adverse effects.

While ambitions should be high, a fully open aviation area with India may take time to develop and may best be developed in stages to allow a smooth transition and market integration based on a gradual implementation of new rules.

- 5.9 The scope of the mandate that the Commission is proposing is outlined in a separate Recommendation to the Council, which includes a proposal for negotiating directives.

On the basis of this, the Commission proposes the negotiation and conclusion of a comprehensive open aviation agreement with the Republic of India and invites the Council to authorise the Commission to enter into negotiations on behalf of the European Community on such an agreement.

The Commission will work closely together with Member States and all relevant stakeholders in further developing and achieving the objectives set out in the negotiating directives.