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Liberalization of International Air Transport in Sri Lanka: Policy Options

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Abstract

Sri Lanka, being an island nation depends on both sea and air for transportation of people and freight. Increasingly air services have become the sole means of transportation of people and have taken on an increasing role as the means of exporting produce abroad. Most of Sri Lanka's major foreign exchange earners – migrant remittances, garment industry, tourism now depend mainly on air services to transport Sri Lankan workers to the Middle East, ship garments to Western markets and bring tourists to the country. While the United States and Europe have been the most significant aviation markets over the past century, most research now indicates that the Asia-Pacific region will become the dominant growth area for aviation services, driven mainly by the huge latent demand in China and India. This is why it is essential for Sri Lanka to quickly position itself to take advantage of its location in the Indian Ocean and to develop itself as an aviation hub for the region.

Given the fact that most countries are moving towards some form of liberalization of their aviation policies, it is imperative that Sri Lanka adopts a progressive and liberal policy, which would serve the country's national interest, keeping in line with global developments in the aviation industry. The government has recognized the important role played by the aviation industry in promoting travel, trade and tourism in the economy. The indications given by the government have been encouraging, and the changes that are pending in terms of airport development, and the adoption of a new civil aviation policy will benefit the country in the long term. Progressive bilateral liberalization with selected partners initially on a reciprocal basis and the adoption of a negative list approach are the best way forward for Sri Lanka in the short to medium-term until a global multilateral framework for aviation is put in place. The Government would be wise not to follow a path of unilateral liberalization when it announces its future Civil Aviation policy as such a move may not provide the kind of long-term benefits that Sri Lanka should strive to achieve.

1. Introduction

Efficient international air services are vital to any country, especially for an island like Sri Lanka, which depends on sea and air for transportation of people and freight. Most of Sri Lanka's major foreign exchange earners – migrant remittances, garment industry, tourism – depend mostly on air services to transport Sri Lankan workers to the Middle East, ship garments to Western markets and bring tourists to the country. By providing links with the rest of the world, air transport not only facilitates business and leisure travel, but also trade, investment and technology transfer. Accordingly, Sri Lanka should seek to conclude with other countries the most liberal and flexible air services arrangements possible, providing for freer access for international airlines and thereby increase competition among them. There have been repeated calls for liberalization of aviation policy in Sri Lanka, with successive governments announcing their intention of adopting an 'open skies'[1] policy and developing Sri Lanka into an aviation hub[2] in South Asia, but this process is by no means complete.

Air transportation has often been on the vanguard of regulatory liberalization in other countries. Governments around the world have been liberalizing their aviation policies, both their domestic and international air services. Domestic aviation markets in the US and the EU have been deregulated through privatization and elimination of subsidies to airlines. A number of countries have also liberalized various aspects of their bilateral air service arrangements. For example, the US has been pursuing the so-called 'open skies' policy since 1978. Countries in the European Union (EU), South America, APEC and ASEAN have also pursued liberalization on a plurilateral and regional basis. On a multilateral basis, the WTO General Agreement on Trade in Services (GATS) has had only very limited application to air transport to date.

Experience has shown clear advantages of freeing the air transport market from economic over-regulation. Liberalization of air services has led to emergence of low-cost carriers, greater competition, reduction in airfares, introduction of new routes and destinations and improved quality of services (ICC, 2001). Given that air transport is an important facilitator of economic activity, liberalization of air transport is also expected to promote efficiency not only of the sector but also other sectors of the economy. However, the structure of bilateral air services agreements (ASAs) that have emerged since the adoption of the Chicago Convention in 1944, which allows countries to control access to their air transport markets, tends to be restrictive and inefficient over global networks of air services. Currently, there are over 3000 ASAs governing international air transport, and Sri Lanka is a signatory to 58 ASAs.

Apart from deregulation of the industry, air transport has undergone a period of dynamic change as a result of technological advances, increased demand, increased competition, emergence of regional economic groupings, privatization and globalization. Adequate responses to these changes have been crucial, not only for the development of the aviation industry, but also for the development of tourism, trade and commerce.

[1] 'Open Skies' is a term usually used to refer to the most liberal type of air transportation agreement between two countries.

[2] A "hub" is an airport where one or more airlines organize a substantial number of arrivals and departures thereby facilitating a flow of traffic (Air Transport Association, 2004). The result is a wide choice of flights not only for connecting passengers, but also for local passengers, who benefit from significantly more flights than warranted by local demand alone. Hubs are used to achieve economies of scale, scope, and density with respect to both passenger and cargo traffic. They allow airlines to use fewer airplanes, personnel, and facilities to offer a more extensive network of service. However, without commensurate expansion in capacity, they can contribute to congestion in certain parts of the country where demand is particularly robust.

While it is commendable that the government of Sri Lanka in keeping with the liberalization and deregulation of the rest of the economy and trends in the aviation industry worldwide would like to pursue such a policy, it is imperative to look at the issues involved closely and to examine whether such a policy is appropriate in the context of Sri Lanka. It is imperative to have a conducive aviation policy in place which would not only lure back airlines that have ceased operations but also encourage countries that have already signed bilateral agreements with Sri Lanka to make use of them. Currently, there are no major European airlines operating to Colombo, despite the fact that Western Europe accounts for the majority of tourist arrivals to the country.[3] With Asia emerging in the 1990s as one of the fastest growing aviation markets in the world, Sri Lanka should strive to benefit from this future growth in the region by emerging as a hub for air traffic in South Asia. This requires adoption of an appropriate aviation policy for the country, as well as upgrading Bandaranaike International Airport (BIA).

The purpose of this paper is to examine the current aviation policy in Sri Lanka and the prospects of further liberalization of air services of the country in the light of developments in the global aviation industry, taking note of the specific needs of a developing economy like Sri Lanka.[4] It also seeks to look at policy options for air service liberalization and suggest pragmatic approaches to be taken. Despite the importance of the air transport industry, there has not been a comprehensive study on Sri Lanka's aviation industry and its policy.[5] Thus, this preliminary study also hopes to provide some useful information about the sector and insights to those who are involved in the industry, which will stimulate further thinking and more in-depth research.

This paper is organized as follows. Section 2 highlights the trends in the aviation industry over the last decade, in terms of scheduled passenger services, cargo and non-scheduled services. Section 3 provides an overview of the development of regulation in the industry and steps taken by individual countries (US, Australia, New Zealand) and groups of countries (EU, APEC and ASEAN) to free air services from regulation hold. Section 4 discusses Sri Lanka's aviation policy, identifies the main aspects of the present policy and looks at the country's bilateral air service agreements, their main provisions and restrictions. Section 5 examines Sri Lanka's airline industry in terms of both passenger and cargo transport. Section 6 considers policy options for liberalization and recommends plausible paths that could be taken while Section 7 looks at the airport and ancillary facilities at present in Sri Lanka and the planned expansion and improvements in the pipeline. Section 8 concludes.

2. International Trends in Aviation

Air transport has for many years experienced greater growth than most other economic sectors. Increasing demand for passenger and freight services (dependent on GDP growth and rising per capita incomes), rapid technological advancement and associated infrastructure development have combined to multiply the output of the industry. Technological advancement has reduced the cost of air travel and time of transportation. However, the rate of growth has been slowing as the industry has become larger and more mature (Commonwealth Government of Australia, 1999). Air travel is also strongly correlated to the tourism industry and the general growth of GDP over time.

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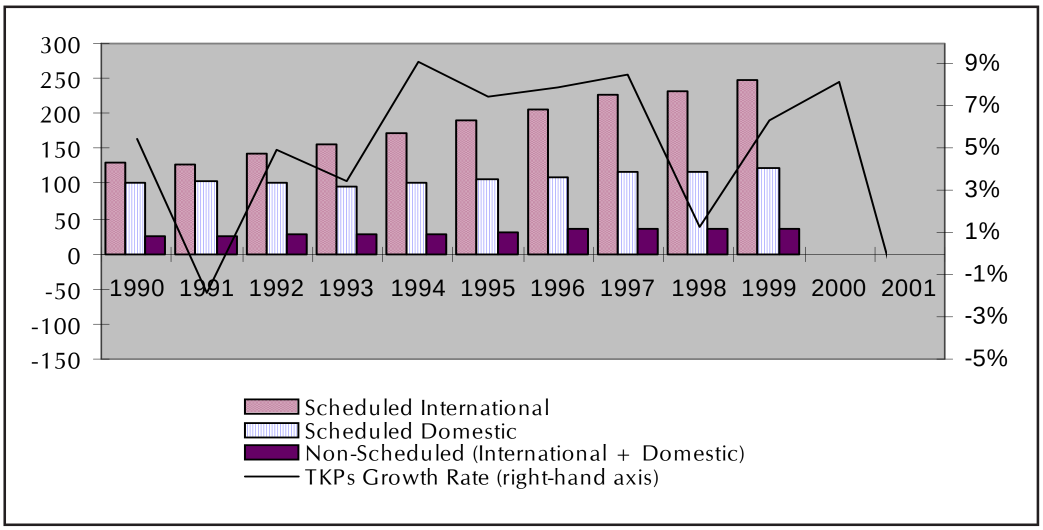
[3] Western Europe is a major source of tourists to the country, accounting for 51 per cent of the arrivals in 2002 (Central Bank of Sri Lanka, 2002).

[4] Countries with the so-called 'open skies policies' are high-income countries, with well-established and large airlines, strong enough to withstand competition from foreign carriers.

[5] Except for the study by Aponso, 2001, which examined the air cargo sector in Sri Lanka.

Total airline traffic, measured in terms of total tonne-kilometres performed (TKP), grew at an average annual rate of 5.5 per cent between 1989-2001(ICAO, 2001). The growth rate of total tonne-kilometres performed (TKP) recorded positive growth rates except in 1991 and 2001, when the growth rate dropped to negative rates due to economic recession in early 1990s and the Gulf War, which discouraged many people from travelling and in 2001 following the terrorist attack in the US (Figure 1). In 1998, the growth rate of air traffic dropped sharply due to the East Asian financial crisis but remained positive. The Airbus Global Market Forecast for 2001-2020 (a survey of most major airlines outside the CIS) predicts that the aviation industry will recover fairly swiftly from its post September 11 slump and return to significant growth. It predicts a 4.7 per cent increase in revenue passenger kilometres (RPKs)[6] over the 2001-2020 period and a 5.5 per cent growth in freight tonne kilometres (FTKs) in the same timeframe.

Figure 1: World Traffic, 1990-2001



Source: ICAO, 2001.

In 1999, nearly 400 million TKP was flown, of which 60 per cent was scheduled international traffic, 30 per cent scheduled domestic traffic and the remainder was non-scheduled international and domestic traffic. The shares of the three categories have remained somewhat unchanged over the years.

In 1999, scheduled airlines flew over 2793 billion revenue passenger-km (RPKs), internationally and domestically. Airlines registered in the United States accounted for over one third (37 per cent) of this total traffic (ICAO, 2000). Scheduled passenger traffic accounted for 69 per cent and 87 per cent of weight carried and revenues earned, respectively (ICAO, 2000).

Freight is a relatively small part of the world's scheduled air traffic, and is often a by-product of passenger services. Freight represented 29 per cent of total world revenue tonne-kilometres performed by scheduled airlines in 1999, and earned 12 per cent of total revenue. Mail traffic (which together makes up 'cargo') accounts for an even smaller share of total weight carried (2 per cent), and revenue earned (1 per cent). Scheduled airlines flew 108 billion freight tonne-km in 1999 (ICAO, 2000). Around 60 per cent of this freight was carried in the bellyholds of passenger aircrafts, and the remainder flown on dedicated freighters.

[6] This is measure of demand based on the number of paying passengers on an aircraft multiplied by the number of kilometres flown.

US accounted for nearly 25 per cent of the total world freight tonne-kilometres performed by scheduled airlines (ICAO, 2000).

Non-scheduled services (including charter) are performed by both scheduled airlines and non-scheduled airlines, but their relative shares in terms of passenger kilometres and freight tonne-kilometres performed are very small. Non-scheduled service accounted for 9 per cent and 10 per cent of the total passenger and freight traffic, respectively in 1999 (ICAO, 2000). Scheduled airlines carry more charter traffic and earn more charter revenue than non-scheduled operators.

Currently, approximately 1200 airlines operate scheduled services worldwide, of which 300 fly internationally (Commonwealth Government of Australia, 1999). Almost every country in the world has its own airline. The United States has five of the eight largest airlines in terms of revenue (Table 1). The largest, American Airlines, earned around US$ 18.9 billion in revenue in 2001, carrying around 78.178 million passengers on 881 aircraft, and employing 118,400 staff.

Table 1: World's Largest Airlines, 2002

		Revenue US$ Mn	Passenger Mn	Employee No	Fleet
1	American Airlines	18,963	78,178	118,400	881
2	United Airlines	16,138	75,457	92,900	543
3	Federal Express	15,166	0	114626	644
4	Lufthansa	14,687	39,694	87,975	236
5	Delta	13,879	104,943	76,273	588
6	JAL	12,373	37,183	16,552	141
7	British Airways	12,176	40,004	57,227	266
8	Air France	11,024	39,067	64,717	254
9	Northwest	9,905	54,056	46,364	444
10	All Nippon Airways	9,265	49,306	1,450	141
	SriLankan Airlines		1.7	4,412	8

Note: 1. Data for some airlines – in particular Japan Airlines and All Nippon Airways – appear to contain inconsistencies vis-à-vis those of other airlines with respect to employee and fleet productivity. It would seem that the data are not collected on a consistent basis across the airlines.
2. (a) 1907

Source: ATW World Airline Report, 2002.

In terms of regional distribution of passenger traffic, North America accounts for 39 per cent of passenger traffic measured in terms of passenger-kilometres performed, followed by Europe (27 per cent) and Asia-Pacific (24 per cent). Although at present the highest amount of passenger traffic is carried by airlines registered in the North American region, it is predicted that within the next ten-year period, the highest traffic will be carried by airlines registered in the Asia-Pacific region (Airbus Global Market Forecast 2001-2020).

3. Regulation of International Air Services

International air transport is governed by a complex set of bilateral air service agreements (ASAs) between countries since the Chicago Convention in 1944, when there was an attempt to produce a liberal multilateral agreement on air transport. The Chicago Convention resulted in the multilateral exchange of the first two freedoms through the International Air Services Transit Agreement of 1945 (IASTA) – see Box 1. However, without an over-arching agreement on the terms and conditions of market access, countries had to negotiate terms on a bilateral basis for all other freedoms, including all rights for parties that were not signatories to the IASTA.

The first bilateral air service agreement (ASA) was reached between the US and UK, two years after the Chicago Convention at a special conference in Bermuda. Bilateral agreements take various forms but most of them are modelled on the 1946 Bermuda agreement between the US and UK, which laid the basis for the bilateral system that continues to govern international aviation more than half a century later. ASAs spell out the terms and conditions under which airlines can operate, such as capacity (in terms of number of seats per week), frequency, routes, cities, ownership, safety provisions, prices, type of aircraft, etc.

Unlike trade in goods, trade in international air services cannot take place unless they are explicitly specified by ASAs which govern international air services. The result has been a highly regulated system based on bilateral, government-to-government negotiations. Foreign ministries as well as transport ministries become heavily involved in determining the parameters under which airlines operate. Although the International Air Transport Association (IATA), founded in 1945 was handed the authority to set fares for international routes, the decisions are subjected to veto by governments. Currently, there are now some 3000 ASAs worldwide (Productivity Commission, 1998), and Sri Lanka currently has 58 ASAs signed with its bilateral partners.

Many of the agreements are restrictive and emphasize protecting national air carriers. The restrictions imposed by the bilateral system have led to a rapid expansion of national flag carriers. The system has allowed countries to strictly regulate traffic between their countries and others, and thereby nurture the development of their own national flag carriers. Some of these national flag carriers such as Singapore Airlines have emerged as highly efficient and profitable world-class carriers, which would have been considerably more difficult under a regime of open market access, whereby dominant airlines at that time would have been free to fly anywhere, anytime, at any price they chose. The majority of the airlines, however proved to be unprofitable to operate and required government support, direct and indirect, to remain afloat. Efficiencies and economies of scale were lost as bilateral restrictions prevented airlines from developing networks on a purely commercial basis. Competition and consolidation were restricted since the system also prevented airlines from establishing themselves outside their country of registration and from taking a majority share or fully merge with foreign airlines. Tight ASA restrictions on competition and trade have turned the international airline industry into one of the most regulated in the world.

While restrictions on trade in goods are generally applied uniformly across member countries of the WTO, trade in international air services are governed by the bilateral agreements, and thus not subject to the principles of Most Favoured Nation (MFN) and National Treatment. As such, international air services arelargely outside the mandate of the WTO and GATS (General Agreement on Trade in Services) except for three areas of air transport, which are included in the transport annex of the GATS. These are: aircraft repair and maintenance services, computer reservation system services and selling and marketing of air transport services. Leasing as a separate service activity is also covered in the GATS.

Box 1: Freedoms of Air

First Freedom	the right of an airline of one country to fly over the territory of another country without landing
Second Freedom	the right of an airline of one country to land in another country for non-traffic purposes such as refuelling or maintenance, while en route to another country
Third Freedom	the right of an airline of one country to carry traffic (passengers, cargo, mail) from its country to another country
Fourth Freedom	the right of an airline of one country to carry traffic from another country to its own country
Fifth Freedom	the right of an airline of one country to carry traffic between two other countries providing that the flight originates or terminates in its own country
Sixth Freedom	the right of an airline of one country to carry traffic between two other countries via its own country
Seventh Freedom	the right of an airline of one country to operate flights between two other countries without the flight originating or terminating in its own country
Eighth Freedom	the right of an airline of one country to carry traffic (cabotage)between two points within the territory of another country

Source: ICC, 2001.

The global aviation industry has reached a critical point. The aviation industry has seen tremendous growth over the years, putting pressure on the bilateral system (see Box 2). The inefficiencies of the bilateral system and the benefits of more efficient, internationally competitive air services are now apparent, and countries are increasingly embracing reform and liberalizing their aviation policy, by terminating one/two airline policy, promoting multiple designation of airlines, privatizing airports, relaxing national ownership requirement for designated carriers, negotiating cabotage, and rights for airlines to operate international air services between other countries without returning home. The remainder of this section will look at deregulation of air services in the US, the EU, Australia-New Zealand, APEC and ASEAN.

Box 2: Pressures on the Bilateral System

- Strong growth in air services, exposing the lack of flexibilities and inefficiencies of the system
- Evidence from around the world of the benefits of deregulation of air services
- Spread of bilateral open skies policies
- Consumer and business demand for better air services
- Use of codeshares, alliances and charters to overcome constraints in the existing bilateral system
- Low profits of airlines and growing reluctance of governments to protect their own airlines
- Privatization of airlines and airports
- Emergence of regional/plurilateral agreements, for example in the EU

Source: Productivity Commission, 1998.

3.1 US

Domestic air services in the US were deregulated as far back as 1978, with the Airline Deregulation Act, which freed the world's largest single domestic air transport market from price restrictions and capacity controls. The outcome of deregulation in the US domestic market was dramatic, with passenger boarding rising by 55 per cent, scheduled revenue passenger miles growing by over 60 per cent and employment in the industry swelling by 32 per cent within a decade (Button, 1998). Cost of flying is estimated to have fallen by 17 per cent. Deregulation also led to a consolidation of airlines into six major carriers (American, Continental, Delta, Northwest, United and US Airways). The industry has also experienced considerable innovation. It was during this period that computer reservation systems expanded dramatically and frequent flyer programmes were introduced. Free to design their own routes, airlines were able to greatly enhance the efficiency of air services through the establishment of a hub-and-spoke system, thereby options being offered to customers. The hub-and-spoke system first developed by American Airlines in the 1980s allowed airlines to collect traffic from small markets and channel it to bigger, cheaper flights between hubs. This system enables airlines to fill their planes by three-quarters rather than flying them half empty. Consumers emerged as the winners from the Deregulation Act, with overall estimated gains amounting to US$15-20 bn per year from greater flight frequency and greater choice. More importantly, economic gains were earned with no noticeable reduction in safety standards. In fact, fatal accidents have fallen dramatically since the deregulation and air transport is an exceptionally safe mode of transport.

In 1979, the Deregulation Act was followed by the International Air Transport Competition Act, which initiated the so-called 'open skies' policy. The open skies policy enables countries to negotiate bilateral agreements and deregulate international travel between the US and other signatory countries. Typically, an agreement under the open skies policy allows US carriers to fly from the US to any point in the other country, with beyond rights and no restrictions on fares/frequency or service, while granting reciprocal rights to the other country's designated carriers. The agreement also includes double disapproval of fares, freedom for airlines to determine capacity and multiple carrier designations with a reduction in route restrictions. By 2000, US had open skies civil aviation agreements with 53 countries.

However, the US market is not truly open and it remains closed to competition from foreign airlines, which are denied cabotage rights. In addition, the US limits foreign investment in US carriers. US allow only 25 per cent of foreign ownership and a maximum of 49 per cent for signatories of open skies agreements. Nevertheless, foreign and domestic carriers have developed mechanisms to get around these problems, by creating airline alliances. Alliances represent an initiative by individual airlines to rationalize their operations, build more effective coverage and offer more seamless, hassle-free transportation in face of regulatory constraints that restrict an airline's ability to acquire/merge across national borders.

The formation of alliance groups has been one of the most significant developments affecting the airline industry. Some of the alliances involve only loose cooperative arrangements such as ticketing, baggage handling or joint frequent flyer programmes. Other alliances involve a much greater degree of integration such as code sharing, joint ground service, joint marketing and sharing of aircraft. Often alliances involve equity investments between airlines in order to strengthen relationships and prevent defection to other competing groups. The number of alliances grew dramatically through mid-1990s. However, four global alliance groupings are emerging, with Star Alliance, Oneworld, Wings and SkyTeam, transporting over 70 per cent of international traffic in 1999.

3.2 EU

Move towards a more open and competitive European aviation market began in the 1980s, with a major step taken in 1985 when the EU Commission was given the authority to decide on air fares, shifting aviation policy from member states to the Commission. Thereafter, three broad packages were adopted to gradually reduce restrictions on intra-European air services.

The first important measure came in 1988 when pricing was partially liberalized and the normal 50/50 decision of traffic on international routes was phased out. A second package was introduced in 1989, which removed capacity sharing arrangements between governments. The reforms also introduced the double disapproval of fares, whereby governments in both countries sharing the route had to object in order to overrule fares set by airlines. The latter prevented governments from discriminating against other European airlines as long as technical and safety standards were met. Ownership regulations were reformed thereby facilitating foreign ownership and the granting of 'beyond rights', which enabled airlines of a home country to fly to a destination in a third country (within the EU). The last round of deregulation was in 1993, which phased in cabotage, bringing about a single aviation market.

Now, any EU airline can fly between member states and between cities within member states without restrictions. Foreign ownership of EU carriers is allowed and carriers have become 'European' airlines. This has led to a considerable increase in cross-shareholding and expansion of code-sharing and alliance amongst the airlines in the region. Studies by the EU Commission confirm the success of deregulation, with an increase in the number of routes flown and number of operators serving, and a reduction in fares since 1993. However, market entry has been slower than expected as most of the EU traffic is carried in an already charter market and there is a lack of capacity at many airports. Deregulation in Europe, like in the US, has led to the emergence of low cost carriers like EasyJet and Ryanair in the UK and Ireland.

3.3 Australia and New Zealand

Privatization and deregulation in Australia and New Zealand have created a competitive industry that has led to lower fares and variety of services offered. New Zealand has taken a step further than the US and is prepared to remove national ownership requirement, to negotiate cabotage and grant seventh freedom, within a bilateral reciprocal arrangement.

The internal Single Aviation Market (SAM) between Australia and New Zealand has been an important accomplishment in recent years, complementing the comprehensive liberalization of trans-Tasman trade in goods and services accomplished under the Closer Economic Relations Trade Agreement (CERTA). Under the SAM, both Australia and New Zealand agreed to have a very liberal air service arrangement between the two countries and even exchange cabotage rights. Despite initial setbacks, the SAM has become Australia's and New Zealand's most liberal bilateral agreement. It authorizes airlines from both counties to fly unrestricted within each other's territory and across the Tasman. The SAM significantly liberalizes air services between the two countries, but does not completely override the Air Service Arrangement between Australia and New Zealand.

The SAM has led to the emergence of new entrants, and the entry of new competitors initially produced substantial consumer benefits in terms of new services and lower fares. However, by early 1997 only one airline out of the three new airlines, which entered the market following implementation of SAM was operating, and subsequently, the traffic levelled off and airfares returned to pre-liberalization levels. However, the overall impact was positive with more variety and availability of services and some reduction in fares. This is becoming more apparent as fierce competition is occurring on the trans-Tasman routes with Virgin Blue poised to enter to market in 2004 and both Qantas and Air New

Zealand aiming to launch low-cost services between the two nations. The benefits are tangible: Qantas aims to reduce its fares to as low as AU$451 (including GST and other taxes) as opposed to their current AU$675 all year fare.

3.4 APEC

The leaders of the APEC countries[7] signed the Bogor Declaration in November 1994, which aims to achieve a free and open trade and investment area by 2010 for industrialized members and by 2020 for the developing member countries. Although some of the APEC governments are of the view that the Bogor Declaration includes liberalization of air services within the APEC region by 2010 (or 2020 for the developing countries), the full implication of the Declaration remains unclear. In fact, it appears not to have been addressed in APEC fora though members have agreed on several initiatives on transportation. For example, the Air Service Group of the APEC Transportation Working Group has identified prospects for liberalizing international air services in eight areas. These included: air carrier ownership and control; tariff; business matters relating to commercial operation of airlines; airfreight; multiple airline designation; charter services; airline cooperative arrangements; and market access (Commonwealth Department of Trade and Regional Services, 2000). So far, there has been little progress made in air service liberalization in the region. Given that consensus is required in a forum like APEC and the sensitivity of the issue concerned, it is unlikely that there would be substantial progress made in air service liberalization through the APEC in the near future.

3.5 ASEAN

ASEAN member countries[8] agreed in 1992 to adapt the Framework Agreement on Enhancing ASEAN Economic Cooperation, which seek further cooperation in the provision of safe, efficient and innovative transportation and communication infrastructure network in the region. In addition, in 1997 they agreed to implement a programme for the ASEAN Plan of Action in Transportation and Communications. This aimed to bring about a regional competitive air service policy within ASEAN, which would remove restrictions on frequency, capacity and aircraft type for point-to-point service between and within member countries. It was proposed to liberalize the market on sub-regional basis initially, and subsequently adopt an “Open Skies” policy for the ASEAN region as a whole. Some progress has been made at the sub-regional level, with liberalization of air services within and between the less developed provinces in the region. However, this arrangement has not been a major stimulus, as the liberal arrangement has not been extended to include major traffic markets.

What all these show is that there is growing concern in the world for liberalizing the aviation policy so as to improve the competition of the aviation industry and support the other economic activities such as tourism, trade, investment, and technology transfer.

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[7] APEC members party to the Bogor Declaration are: Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, the Philippines, Singapore, the Republic of Korea, Taiwan, Thailand, and the United States. Peru, Russia, and Vietnam were admitted as member economies in November 1997.

[8] ASEAN currently consists of 10 countries in South East Asia and includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

Box 3: What is an 'Open Skies Policy'?

The concept of 'open skies' is not uniformly defined by the international community. Reference to 'open skies' may refer to the creation of a regulatory regime that allows total freedom of access, unlimited capacity and no control on pricing. Safeguards within such arrangements are normally restricted to the minimum regulation necessary to achieve the goals of the agreement. Countries, which claim to pursue an open skies policy, do not have an 'open' or free access to their air transport market, as the term suggests. Hence, the phrase 'open skies' can be somewhat misleading.

Usually, open skies policy refers to the U.S. model of open skies agreement, which generally incorporates removal of restrictions on third, fourth, and fifth freedom traffic, airfare regulation and number of designated carriers. This type of agreement maximizes potential competition and facilitates new services through cooperative arrangements among the participating countries' airlines. Some fifty accords have been signed by the year 2000 (ICC, 2001). However, seventh freedom rights are negotiable but cabotage rights are not and the limits on foreign ownership of US carriers is restricted. In fact, the US has one of the largest and most protected domestic aviation markets in the world. Even the US open skies model preserves many of the anachronisms that distinguish the international air transport sector from most other global industries.

New Zealand has also adopted a bilateral open skies policy with a number of countries. The New Zealand model is based on the US open skies Model but adopts a more liberal approach to foreign ownership than the US, which currently restricts foreign ownership in US carriers. Unlike the US, New Zealand is also prepared to negotiate seventh freedom rights and cabotage rights on a reciprocal basis.

In 2002, there were some 85 open skies agreements involving approximately 70 countries. These agreements cover an increasing number of developing countries, with two-thirds involving the US as one of the partners.

Source: ICAO Secretariat, 2003.

4. Sri Lanka's Aviation Policy

Until recently, the Ministry of Tourism and Aviation together with the Department of Civil Aviation (DCA) have been, responsible for formulating aviation policy, and regulating international operational and safety standards in the industry, respectively. However, all matters pertaining to Civil Aviation were brought under the newly formed Civil Aviation Authority (CAA), which was created on 27 December 2002 by an Act of Parliament (No.34 of 2002) giving it more flexibility for policy making and implementation.

Current official policy relating to aviation dates back to 1996, which is spelt out in the Aviation Policy Statement (Ministry of Tourism and Aviation, 1996). Aviation policy has been formulated keeping in line with the overall economic policy of the country. Accordingly, the development of civil aviation is to take place within in a free market economy, moving away from past policies based on protectionism and regulation. It is interesting to note that prior to 1950, Sri Lanka (or Ceylon as it was called then) had a very liberal aviation policy, which subsequently changed with the Air Navigation Act No. 15 of 1950. The Act set out provisions for general regulations and control of air navigation, and brought air services under state control as well as operation.

Box 4: The Civil Aviation Authority Act (December 2002)

This Act created the CAA and established the parameters that define its operating role as the regulator of civil aviation policy. Its board is to consist of eight members, namely: the Secretary of the Ministry of Defence, the Secretary General of Civil Aviation, a representative of the Ministry of Finance and five members appointed by the Minister, no less than two of whom should have 'considerable experience or knowledge' in the field of aviation. One of the members would be appointed as Chairman and another as Vice-Chairman. The main functions of the CAA include:

1) Regulating all civil aviation operations within Sri Lanka and operations of Sri Lankan registered aircraft outside Sri Lanka
2) Assisting in the formulation of the National Aviation Policy
3) Preparing a national Aviation Development Plan with the Minister of Civil Aviation
4) Assisting with international air services negotiations

The new CAA is financially autonomous from the Government and it is financed from revenue gained through issuing or renewing licences and permits necessary to operate all civil aviation related activities in Sri Lanka and charges levied on other services rendered by the CAA. The government may, however, grant monies to the CAA from time to time if necessary. All property and items owned by the Directorate of Civil Aviation were transferred to the new CAA.

The main aspects of the 1996 civil aviation policy include:

- Pursue a policy of managed liberalized access rather than unbridled access to Colombo, that is, open skies policy;

- Scheduled operations to take place under a bilateral Air Services Agreement and reciprocal traffic rights to be exchanged, observing the principle of fair and equal opportunity;

- Non-scheduled (charter) operations to be allowed, subject to charter regulations being complied, and such operations from tourist generating countries, which are not served by scheduled carrier operations, to be encouraged;

- Encourage both local and foreign carriers to operate cargo services in and out of Sri Lanka, and develop cargo village in BIA;

- Air Lanka (now SriLankan Airlines) to operate in open competition with other scheduled carriers; reduce government assistance to the national carrier. Privatize /restructure the national carrier at an appropriate time and encourage foreign capital and management (This has taken place since the 1996 aviation policy coming into effect);

- Designation of Air Lanka as the sole national carrier in bilateral air service agreements. Make Air Lanka the lead agency of Sri Lanka's aviation industry, and thereby contribute substantially towards the national economy;

- Pursue discussions to link capitals of the South Asian countries;

- Improve facilities at the BIA to meet increase in traffic and endeavour to make Colombo a hub;

- Look into the proposal to construct an alternate international airport (ICAO requires all international airports in the world to have a nominated alternate airport within the territorial bounds of the country. At present, the nominated alternate airport to BIA is Madras Airport, located 350 nautical miles north of BIA);

- Encourage the private sector to take the lead in the development of domestic aviation and to provide suitable facilities to operate domestic airlines. Develop existing domestic airports in the country for the operation of private domestic airlines, including Ratmalana Airport, which is to serve as the primary base for domestic operations.

Sri Lanka's international aviation services policy for many years was conducted largely according to the interest of Air Lanka (now SriLankan Airlines). It was a case of what was good for Air Lanka was good for the country. In turn, Air Lanka's pursuit of commercial objectives was conditioned by what it perceived or was encouraged to perceive, were national objectives. Despite the privatization of Air Lanka and the airline under the management of Emirates being allowed to operate on a more commercial manner, the interests of the national airline still remain a predominant factor in the country's aviation policy. Although SriLankan Airlines has not received any subsidies or funding from the government since the privatization, it still enjoys rents in the form of monopoly handling rights and catering as well as sole designation as the national carrier of Sri Lanka.[9]

On the other hand, SriLankan Airlines is still faced with the dilemma of being expected to operate to many destinations as the national carrier while at the same time being expected not to make losses at the end of the year. There was a furore amongst the local travel trade when the airline ceased its operations to Germany, amongst other destinations following the airport incident in July 2001, and commenced some of the operations to European and Far Eastern destinations through Male. It was argued that this has put Sri Lanka at a disadvantageous position in the promotion of its tourist industry, inconveniencing passengers coming to Sri Lanka. However, it has to be recognized that the airline is in business now rather than the government and cannot afford to operate unprofitable routes.[10]

Nevertheless, the country's aviation policy should be liberalized to allow other domestic carries to fly internationally. Under the SriLankan-Emirates Agreement, Sri Lankan Airlines was granted the sole designation as the national carrier till 31 March 2004. So far the government has reserved the right to appoint any other domestic airline for international operations though domestic operators have expressed/shown an interest in commencing international flights.

Sri Lanka's ASAs need to take an economy wide approach and consider a wider range of interests in bilateral negotiations, giving sufficient consideration to the interests of the passengers, the tourism industry, the State in addition to the aviation industry itself. Figure 2 illustrates the impact of aviation policy on the economy. Although the stated objectives of Sri Lanka's international aviation policy include the interests other than the business interests of the airline, they have not been fully reflected in practice.

A new national civil aviation policy is expected to be formulated, which will be more liberal, with provisions for more private sector participation in the industry. The government is planning to pursue

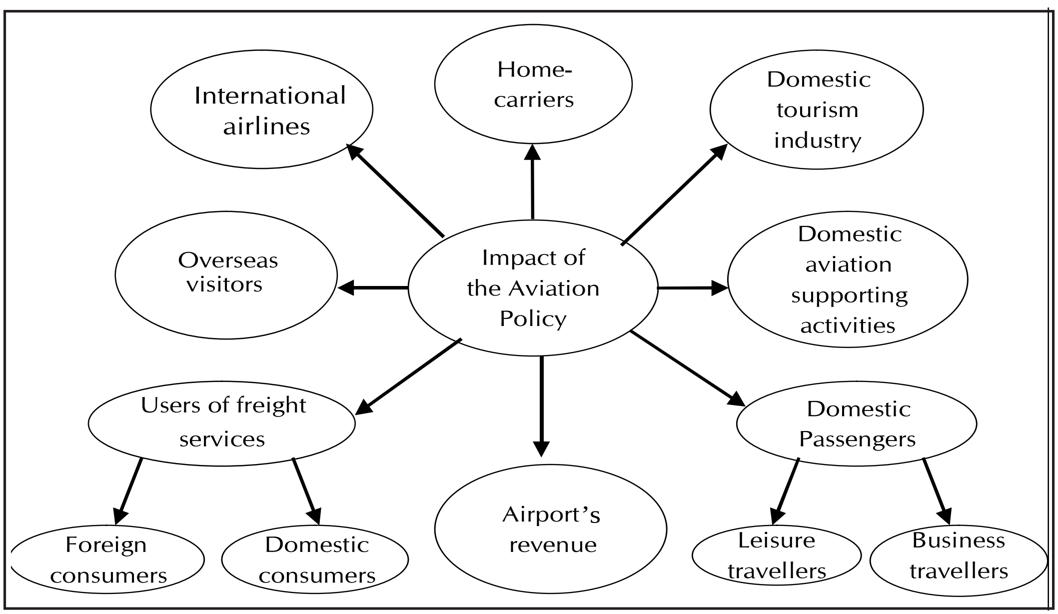
[9] The sole designation of SriLankan Airlines expired in 31 March 2004 while it will enjoy monopoly rights for handling and catering till 1 April 2008.

[10] "We operate as a commercial entity but keep in mind the national interest," SriLankan Airlines Head of Commercial G.T. Jeyaseelan (Sunday Times, 3 March 2002).

an open skies policy by granting fifth freedom traffic rights into addition to third and fourth freedom rights to encourage airlines to operate into Sri Lanka. In return, Sri Lanka would seek reciprocal traffic rights in those countries for Sri Lankan carrier as well. The government is expected to adopt an open skies policy by 2005, with the possibility of allowing domestic airlines to operate international passenger services.

The Air Navigation Act of 1950 is also expected to be replaced with a Civil Aviation Act to provide an updated legal framework to meet modern-day requirements of civil aviation. The new Civil Aviation Act has provision for the Minister of Civil Aviation to appoint "service providers" for a wide range of activities. These include catering and ground handling which are currently monopolies of the national carrier, SriLankan Airlines. Under the new Act, airline operators will also be able to do their own ground handling if they wish to do so. However, operators who do not wish to do their own ground handling, which is a specialist service involving big investments, can go to the designated sole ground handling agent which is SriLankan Airlines. Likewise, catering too will be opened up to competition. Airports and Aviation Services Ltd., a government-owned business undertaking that operates the Bandaranaike International Airport (BIA), will be called a service provider under the new Act and be licensed and regulated by the Civil Aviation Authority. The new act will facilitate privatization of the airport and other airport services.

Figure 2: Impact of Aviation Policy



Source: Law and Yeung, 2000.

4.1 Sri Lanka's Air Service Agreements (ASAs)

As a signatory to the IASTA, Sri Lanka is required to grant first and second freedom rights to carriers of other signatory nations. Sri Lanka presently has 58 ASAs with other countries but only 28 countries use these agreements. Most of the ASAs have been signed in order to facilitate future services between the respective countries as well as to strengthen bilateral relations. Some of these were signed more as result of political expediency to further relations amongst the countries rather than for commercial interests. ASAs and attached MoUs usually contain information about the agreements signed between Sri Lanka and other countries. ASAs usually follow a standard template but differs from country to country depending on the requirements and needs of each country.

ASAs typically include the following provisions:

- grant rights to the contracting party to enable its designated airline/s to establish and operate services on specific routes
- designate and authorize airline to operate on specified routes, subject to the condition that the airline is incorporated and has its headquarters in the contracting party, holds a licence issued by the aviation authority of the contracting party and the airline is substantially owned and effectively controlled by nationals of the contracting parties
- revocation, suspension and limitation of authorization of the airline of the contracting party, temporarily or permanently if it fails to meet the conditions set out in the Agreement
- agreement on the principles of fair and equal opportunity for airlines designated under the Agreement
- exemption from import duty by both parties for aircraft fuel, spare parts and supplies used by airlines of the other party
- agreement on principles for regulating capacity and tariffs
- mutual recognition of airworthiness and competence certificates
- agreement to ensure that user charges on designated airline of the contracting party for the use of airports and other facilities are just and reasonable
- agreement to cooperate on aviation security
- grant rights for the designated carriers of one party to conduct business in the country of the other party
- provision of information regarding authorizations of services and consultations from time to time to ensure satisfactory compliance of the provisions in the Agreement
- agreement on the procedure for the settlement of disputes
- description of the routes over which agreed services can operate (contained in the annex)
- agreement that both parties will amend air services arrangements to conform with any matter covered by any multilateral agreement to which both parties have entered.

While the ASAs contain a number of provisions, which facilitate the operation of international air services between Sri Lanka and other countries, they also contain a number of restrictions. Key restrictions, which affect the efficiency of airlines, are:

- **Ownership and effective control:** The bilateral system has been built on the premise that each country has its own substantially owned and controlled designated national flag carrier/s. Under Sri Lanka's ASAs, designated carriers are required to be 'substantially owned and effectively' controlled by nationals. The result of the bilateral system is an international misallocation of resources as some countries waste scarce resources on inefficient airlines that would be not viable without government support. On the other hand, countries with efficient airline industries are unable to expand their airlines to their full potential. Due to the need to have 'national airlines' under bilateral agreements, governments tend to restrict foreign investment in airlines.

As a result, air carriers cannot establish themselves outside their national state and cannot generally take a majority share in a foreign airline. There are examples of multi-national airlines but these are exceptions. Many airlines around the world are still state owned, and there has been a long tradition of subsidizing certain aspects of air transport for political, social, economic and strategic reasons. Although subsidies have been diminishing as air transport has become more commercially oriented, they still remain in place. While in some cases the subsidies are direct and monetary in kind, in others they come in the form of route licensing and state monopolies. Thus, reform of national designation is important for liberalization of the bilateral system but the options available are limited given the perfect bilateral system.

- **Capacity constraints:** Capacity is often used as a bargaining chip and remains restricted in most bilateral agreements. Capacity constraints can retard growth of the market, airlines of the countries concerned and other dependent industries such as tourism (ICC, 2001). If third country carriers have capacity on such constrained routes, consumers may not be greatly disadvantaged, although prices are likely to be higher and choice constrained. Airlines of the bilateral agreement may lose their market share if they are constrained from limits on capacity and are unable to meet growing demand, which could be supplied by third countries on such routes. Limits on the overall capacity to be used by Sri Lankan airlines and foreign designated carriers are contained in all Sri Lanka's ASAs except with the US and Maldives. These limits are generally specified in terms of number of flights, seats and aircraft that a country's carrier can operate a week, although most ASAs are specified in terms of frequency. According to bilateral arrangements, 50 per cent of the traffic to and from the country has been given to the national carrier, SriLankan Airlines and the remaining share to the designated operator of the other country. Capacity is predetermined and not open to market forces, unless agreed by both parties. In most cases, capacity limits have not led to situations where there has been a lack of seats available to and from Colombo except in a few instances that have been temporary in spell. Usually, capacity negotiated is greater than what is required and takes into account future growth in the route. Nevertheless, capacity has been a constraint to flights operating to and from India, Saudi Arabia and Japan. In the case of India, seats were limited to 4025 a week for each of the designated operators, SriLankan Airlines and Indian Airlines till recently.

- **Fifth, sixth, and seventh freedom of rights are not encouraged.** Aviation policy encourages traffic between two points in order to promote the country and as such third and fourth freedoms are pursued as a policy.

- **Cabotage:** Cabotage refers to the right to carry traffic internally. Sri Lanka has not granted cabotage rights to any foreign carriers under its ASAs.

- **Designation:** Policy has designated Air Lanka (now SriLankan Airlines) as the only designated national carrier in bilateral air service agreements. Sri Lankan-Emirates Agreement restricts designation of other carriers of Sri Lankan ownership to operate international routes till April 2004.

- **Prices**: IATA sets prices but in practice operators are allowed to determine the tariff according to market forces. However, there have been instances in the past when due to unfair competition from over-capacity into and out of Colombo, a Market Development Programme (MDP), consisting of airlines and travel agents, was set up to determine minimum price and to impose self regulation in the market. MDP is no longer in force.

Despite liberalization in many countries, most ASAs still prevent airlines from operating like other companies. One reason for the slow progress of reform lies in the ASAs themselves. The 'positive list' of activities that an airline is allowed inhibits airlines from undertaking anything for which there is no provision. Airlines have to approach their governments before they can develop new or even expand services.The bilateral system restricts airlines'ownership and access to capital, where to fly, the number and frequency of flights, the number of seats they can offer, the type of aircraft they use and how much they charge. It affects competition between airlines by controlling market entry and the quantity and variety of rights allocated to particular airlines. The system also influences airline costs – usually by increasing costs by restricting airlines' ability to operate efficiently, develop new markets and more effective networks. Increased costs and restricted competition lead to higher prices. Regulation of entry, frequency, capacity, routes and prices keeps fares up and impedes the development of new travel products. Liberalization has led to greater competition elsewhere, with reduction in fares, introduction of new routes and destinations, and improvement in quality of services.

5. Sri Lanka's Airline Industry – Passenger and Cargo

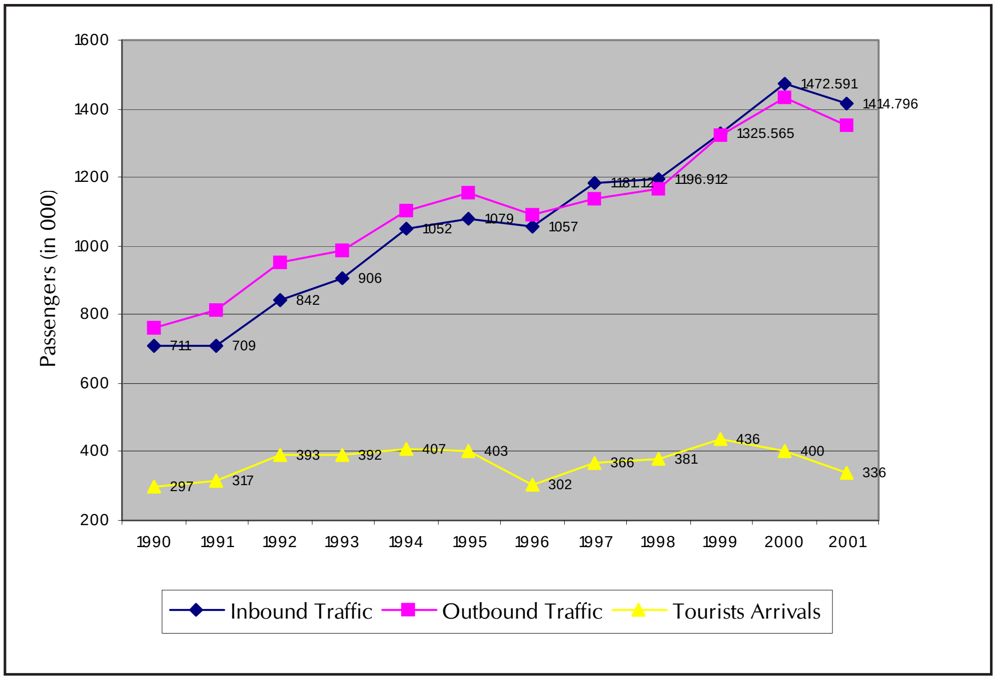
The number of passengers and tonnes of freight and mail carried to and from Sri Lanka depend on several factors. Some of them are: level and growth of income of the country, relative cost of travelling, relative attraction of country as a tourist destination or as a hub (financial, investment), prevailing security situation in the country and so on. Although Sri Lanka is branded mainly as a tourist destination in the region and is categorized as a low-middle income country, its demand for air travel is relatively higher given its level of economic development and per capita income due to migration of Sri Lankan workers for jobs abroad.

Growth of international passenger and freight traffic carried to and from Sri Lanka has been rapid; average annual growth rates of 8 per cent and 14 per cent, respectively were recorded between 1990 and 2001. During this period, passenger traffic has nearly doubled and cargo traffic has trebled. However, the civil aviation sector suffered a serious set back in July 2001 after the terrorist attack on BIA and the September 11 terrorist attacks in the US. This was compounded by the slowdown of the world economy, which adversely affected the travel market. The terrorist attack on BIA destroyed half the fleet of the national carrier. Following the attack insurance premia on aircraft passing through Colombo skyrocketed. Some of the reputed international airlines pulled out from Colombo while other carriers reduced the number of flights. Airlines which continued to operate switched to older aircraft to avoid paying heavier premia. Following the September 11 attack in the US, war risk premia was further increased, bringing air traffic to BIA to a virtual standstill. With some semblance of peace returning to the country following the ceasefire agreement signed by the government and the LTTE in 2002, traffic into BIA has begun to pick up again with airlines recommencing flights to BIA and a number of new airlines flying into Colombo carrying tourists and SriLankan Airlines adding more destinations to its route network and expanding its fleet. In fact, tourist arrivals to the country for the first time passed the 500,000 mark in 2003.

5.1 Total International Passenger Movements

The total number of passengers carried to and from Sri Lanka on both scheduled and non-scheduled flights increased from approximately 1470 thousands in 1990 to 2767 thousands in 2001. This represented an average annual growth for inbound and outbound traffic of 9 per cent and 7 per cent, respectively. Inbound and outbound traffic refer to all passengers arriving or departing from Sri Lanka. The highest annual increase occurred in 1992 when inbound traffic and outbound traffic increased by 19 per cent and 17 per cent respectively. However, the annual growth of inbound and outbound traffic slowed markedly in 1996 and 2001, mainly as a result of civil disturbances in the country, world economic slowdown during the two periods, and particularly in 2001, following the terrorist attacks at BIA and in the US; the latter affected both the global economy and confidence in air transport.

Figure 3: Inbound, Outbound Traffic and Tourist Arrivals, 1990-2001



Source: Compiled from data provided by the Department of Civil Aviation and Ceylon Tourist Board, 2001.

5.1.1 Inbound Traffic

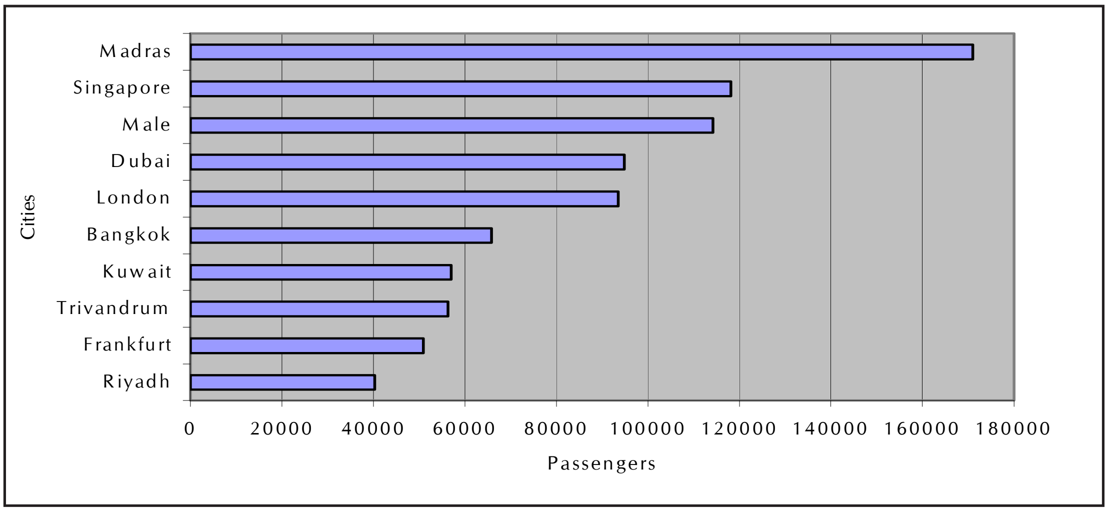
Approximately, 1472 thousands passengers arrived in Sri Lanka in 2000, of which around 400 thousands comprised tourists[11] (27 per cent of the total arrivals to the country), while the remaining were returning Sri Lankan residents. Bandaranaike International Airport is the main port of tourist arrivals by air, with 99.9 per cent share of the total tourist traffic. The balance 0.1 per cent used the Colombo Harbour as the port of entry by sea (Sri Lanka Tourist Board, 2001). During 1990-2001, changes in tourist arrivals to the country were reflected by changes in inbound traffic to the country. Drops in tourist arrivals in 1990, 1996 and 2001, are clearly visible by the drop in inbound traffic during these periods (Figure 3).

The largest number of inbound traffic was from Madras in 2000, followed by Singapore and Male. Inbound traffic from the top ten cities to Sri Lanka accounted for approximately 29 per cent of the total arrivals to the country (Figure 4). India has emerged as Sri Lanka's major source of inbound traffic in recent years. Madras and Trivandrum are amongst the top ten cities with the largest inbound traffic to the country. London and Frankfurt are major gateways for traffic from Europe to Sri Lanka. Dubai, Kuwait, and Riyadh are important cities due to the large population of Sri Lankan migrant workers present in these countries who are either returning to the country or coming for vacation. Singapore and Male are important transit cities for both tourists and Sri Lankan residents coming to the country.

[11] A "tourist" is defined as a visitor who spends at least one night in the country (Sri Lanka Tourist Board, 2001).

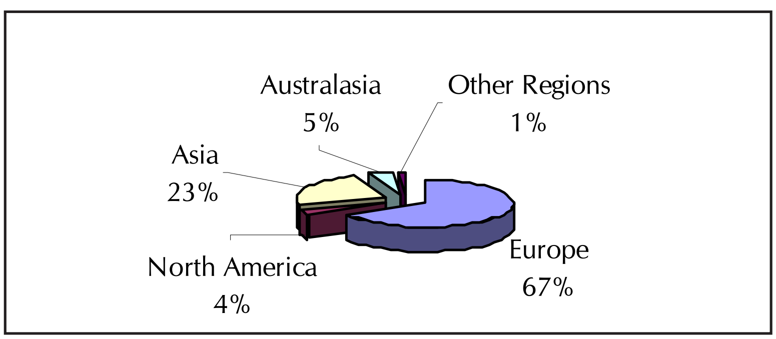
Tourist arrivals to Sri Lanka have stagnated around 400 thousand during 1990–2001 period, mainly due to the uncertain situation prevailing in the country. Tourist arrivals to the country varied from a high of 436 thousands in 1999 to a low of 296 thousands recorded in 1990. Majority of the tourist arrivals were from Western Europe, which accounted for about 67 per cent of the total tourist arrivals to Sri Lanka, while Asia and Australia secured second and third place in terms of ranking of tourist arrivals by region, respectively (Figure 5). The majority of tourists visited the country for vacation, while about 10 per cent came for other purposes. The other purposes were mainly business, visiting friends and relatives and religious and cultural purposes. Out of the total arrivals, 78 per cent travelled in regular inter-regional flights, 19 per cent arrived in regular intra-regional flights and 3 per cent in charter flights (Central Bank of Sri Lanka, 2001).

Figure 4: Passengers from Top Ten Cities To Sri Lanka, 2000



Source: Compiled from data provided by the Department of Civil Aviation and Ceylon Tourist Board.

Figure 5: Tourist Arrivals by Region, 2000



Source: Compiled from Ceylon Tourist Board, 2001.

5.1.2 Outbound Traffic

Outbound traffic has been increasing at an average annual rate of 7 per cent in the period 1990-2001, except for the years 1996 and 2001 when there was negative growth due to civil disturbances and bad economic conditions in the country. In 1990, the total number of outbound passengers were around 759 thousands; this figure reached 1352 thousands by 2001. In 2000, the largest number of outbound passengers from Sri Lanka flew to Madras, which was around 180 thousands. Madras accounted for 13 per cent of the total outbound passengers. In second and third places are Singapore and Male, respectively. As we can expect, the major cities for inbound traffic are also the major traffic for outbound traffic, but with slight differences in terms of their ranking.

Table 2: Airlines Serving Colombo, 1995-2002

	1995	1996	1997	1998	1999	2000	2001	2002
Aeroflot Soviet Airlines	Y	Y	Y	Y	Y	Y	Y	N
Air Europe	Y	Y	Y	Y	N	N	Y	Y
AOM French Airlines	Y	Y	Y	Y	Y	N	N	N
Balkan Airlines	Y	Y	Y	Y	Y	N	N	N
Cathay Pacific	Y	Y	Y	Y	Y	Y	Y	N
Condor Airlines	Y	Y	Y	Y	Y	Y	Y	Y
CSA Czech Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Emirates	Y	Y	Y	Y	Y	Y	Y	Y
Eurofly	Y	Y	Y	Y	N	N	Y	Y
Gulf Air	Y	Y	Y	Y	Y	Y	Y	Y
Indian Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Kuwait Air	Y	Y	Y	Y	Y	Y	Y	Y
Lauda Air	Y	Y	Y	Y	N	N	N	Y
LTU International Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Malaysia Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Maldives Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Martin Air	Y	Y	Y	Y	N	Y	Y	N
Middle East Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Oman Air	Y	Y	Y	Y	Y	Y	Y	Y
Pakistan International Airlines	Y	Y	Y	Y	Y	Y	N	N
Qatar Airways	Y	Y	Y	Y	Y	Y	Y	Y
Royal Jordanian Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Saudi Arabian Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Singapore Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Sri Lankan Airlines	Y	Y	Y	Y	Y	Y	Y	Y
Thai Airways	Y	Y	Y	Y	Y	Y	Y	Y

Note: "Y" denotes operation; "N" denotes discontinuation of operation.
Source: Compiled from data provided by Airport and Aviation Services Ltd.

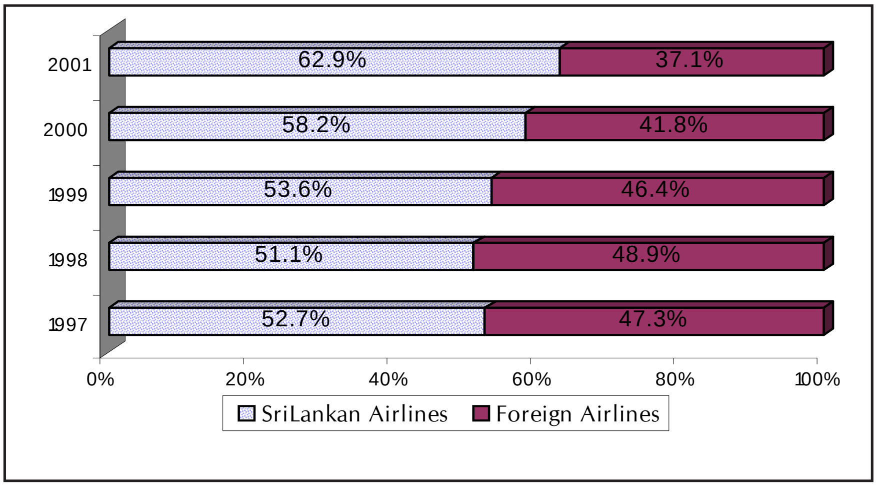
5.1.3 International Passenger Market

Currently, there are nearly 20 scheduled airlines operating to and from Sri Lanka including the national carrier, SriLankan Airlines (Table 2). Non-Scheduled carriers or charter flights normally operate during a particular time of the year and carry mostly tourists from Western Europe.[12] Scheduled operators carried nearly 93 per cent of the total tourists in 2000.

[12] Air Holland, Transavia Airlines, City Birds are some of the charter flights which operated to Sri Lanka in 2000.

Sri Lanka currently has only one designated international airline – SriLankan Airlines. Sri Lankan Airlines is a minor player on a world scale in terms of revenue earned, passengers carried, staff maintained, fleets operated but it plays an important part in the country's economy.[13] Although its share in total world RPKs is negligible, accounting for less than 1 per cent of world RPKs, the airline carried about 2 million passengers to and from the country and accounted for over 50 per cent of the total inbound and outbound traffic to Sri Lanka. Its share has gradually increased over the years (Figure 6). SriLankan Airlines handled almost 62 per cent of inbound traffic and 63 per cent of outbound traffic in 2001. In 2000, these figures were 57 per cent and 58 per cent, respectively. This is mainly due to two reasons: one, SriLankan Airlines expanded its fleet and introduced new destinations and frequencies after it privatized in 1998; two, the security situation in the country as well as the non-viability of flights to and from Colombo has prompted some airlines to cease their operation. For examples, Pakistan International Airlines, AOM French Airlines pulled out of Colombo in 2000.

Figure 6: Share of Total Passengers, Carrier wise, 1997-2001

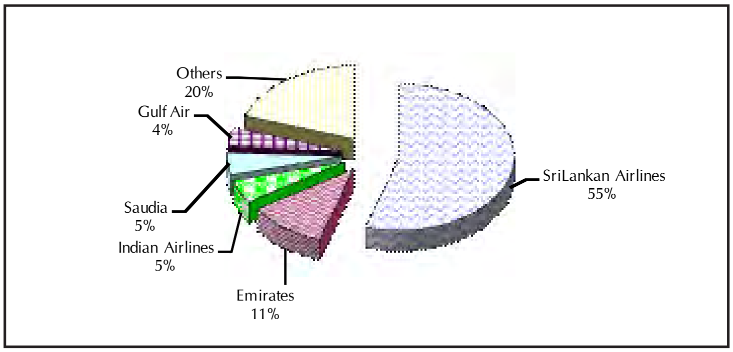


Source: Compiled from the Sri-Lankan Airlines Annual Reports.

Other leading scheduled airlines operating to Sri Lanka are Emirates, Indian Airlines, Saudia and Gulf Air (Figure 7). These 5 international airlines together accounted for 80 per cent of the total capacity to the country. SriLankan Airlines is in a strong position compared to other airlines at their home airports (Table 3). SriLankan Airlines accounts for more than half of traffic to Sri Lanka (63 per cent of passengers to and from BIA). Cathay accounts for a third of Hong Kong's passengers travelling in and out of the city. At Singapore's Changi Airport, Singapore Airlines accounts for 52 per cent of air movements, and at London's Heathrow, British Airways accounts for 38 per cent.

[13] It plays a vital role in the economy and accounts for about 4 per cent of Sri Lanka's GDP and substantially contributes to the country's foreign exchange. It earned Rs. 21.9 billion, which is greater than the receipts received from tourism (Rs. 19 billion) and total foreign direct investment (Rs. 7.9 billion).

Figure 7: Share of Total Seating Capacity, Carrier-wise, 2001



Source: Compiled from the Ceylon Tourist Board, 2001.

Box 5: Background to Sri Lankan Airlines

SriLankan Airlines started out in 1979 under the name Air Lanka which took over from the former Air Ceylon, and the airline began operations with two leased Boeing 707s. With initial management assistance from Singapore Airlines, Air Lanka, based in Colombo, commenced operations with just seven destinations and less than 250,000 passengers in the first year. The airline continued to grow during the 1980s adding to its fleet and increasing its destinations. By January 1990 Air Lanka had increased its original network to a total of 26 destinations.

In 1998, as part of its forward-looking strategy the airline underwent a change in both corporate structure and identity. A corporate restructuring process resulted in Emirates Airline of the UAE entering as a strategic partner. Emirates acquired a 40 per cent stake in the carrier for a sum of US$ 70 mn[14] and undertook the management of SriLankan Airlines for a period of 10 years (until March 2008). In 1998, Air Lanka's fleet consisted of 4 Lockheed Tristars, 3 Airbus A340s and 2 Airbus A320s. Prior to its privatization, Air Lanka was fully owned by the government and its affiliates. SriLankan Airlines is also the only ground handler at Bandaranaike International Airport (BIA) and its subsidiary is the sole provider of airline catering at BIA until March 2008. The need for privatization reflected the need to replace an ageing fleet, need for a long-term business strategy and an infusion of management vision, and access to synergies through a linkup with a strong technical partner (PERC website).

'SriLankan Airlines' replaced the name 'Air Lanka'. As of 2002 SriLankan Airlines flies to 30 cities in 20 countries in Europe, the Middle East, the Indian sub-continent and Far East carrying over 1.5 million passengers per annum. One of the major changes since corporate restructuring was the fleet renewal programme, which saw six brand new Airbus A330-200s entering the fleet and the Lockheed Tristars being phased out. In 2000/2001 the A330-200s complemented the four A340-300 long-haul aircraft, and two A320-200 short-haul aircraft the airline had, to form an all-Airbus fleet. SriLankan unfortunately lost one A340, two A330s and an A320 in the terrorist attack at the Air Force installation adjacent to the Bandaranaike International Airport in Katunayake, Sri Lanka on 24th July 2001.

[14] Sale of 40 per cent of shares in Air Lanka Limited, in two tranches, to Emirates for US$ 70 million - 26 per cent of shares sold to Emirates for US$ 45 million in March 1998.

Table 3: Airline Dominance

Country (city)	Major Home-Carrier(s)
Hong Kong	Cathay Pacific (32.4%); Dragonair (3%)
United Kingdom (London)	British Airways (38.3%); British Midland (6%)
Germany (Frankfurt)	Lufthansa (59.8%); Condor Flugdienst (3.8%)
France (Paris)	Air France (55.2%)
Canada (Toronto)	Air Canada & Canadian Pacific (80%)
Thailand (Bangkok)	Thai Airways (52%)
Malaysia (Kuala Lumpur)	Malaysia Airlines (70%)
Japan (Tokyo)	Japan Airlines (28%); All Nippon Airways (9%)
South Korea (Seoul)	Korean Air (48.2%); Asiana (18.8%)
Singapore	Singapore Airlines (52%)
Australia (Sydney)	Qantas Airways (40%);Ansett Australia (35%)
Sri Lanka (Colombo)	SriLankan Airlines (63%)

Note: Market share of passenger traffic indicated within brackets.

5.1.4 Domestic Passenger Market

Domestic flights were banned in 1996 amid fears that the rebels would hijack a domestic airline to carry out an attack. However, civilian passenger shuttle service was then placed under the purview of the Sri Lanka Air Force, which operated a Lionair aircraft and aircrew under its Helitours civil flights operation. In 2002, Sri Lanka lifted a six-year ban on domestic flights thereby clearing the way for commercial airlines to resume services to the war-ravaged Jaffna peninsula. The ban had been removed because of the improved security following the truce with the separatist Tamil Tiger rebels in February 2002.

So far 13 companies have submitted applications for requesting permission to commence domestic civilian operations from the Department of Civil Aviation (now Civil Aviation Authority), of which five have been approved but only three companies (LionAir, Serendib Air and ExpoLanka Aviation) are in operation. The main route is Colombo-Jaffna and there are about 10 flights per week on that route. Sri Lankan Airlines is the latest operator to enter the domestic aviation segment with the introduction of air taxi services, flying to 7 local points (Kandy, Koggala, Bentota, Trincomalee, Dambulla, Hingurakgoda and Anuradhapura).

5.1.5 Charter Operations

Non-scheduled services are air services which are not listed in a published timetable. They are generally operated on an irregular or infrequent basis. Charter flights are one form of non-scheduled services. The terms 'non-scheduled' and 'charter' are often used interchangeably. In some parts of the world, non-scheduled services provide significant competition to scheduled international services. Charters in Europe and across the Atlantic account for a significant proportion of the overall market. They have developed in response to market circumstances, such as the high seasonality of passenger and freight traffic and partly in response to regulatory constraints on scheduled services. The regulation of non-scheduled services is generally outside the bilateral system, which tends to cover scheduled passenger and freight services only. However, some arrangements such as the US 'open skies' agreements contain provisions relating to non-scheduled services. A few regional agreements also cover non-scheduled services.

The authorization of charter services remains at the discretion of individual countries. A proposed charter service must generally meet the charter requirements of both countries before they can commerce operations. The national regulation of charter services varies from country to country. While some countries, particularly tourist destinations, readily authorize incoming charter flights, other have adopted a more restrictive approach. In the case of Sri Lanka, DCA (now CAA) is responsible for approving the operation of charter services, subject to charter operators meeting the following criteria: passengers carried are mainly tourists and the flight originates from tourist generating markets. In the past, Sri Lanka's charter policy has been restrictive towards charter operations flown by scheduled services but it has been relaxed over the years and charters are now directly competing with scheduled operators such as SriLankan Airlines on certain routes.

In 2000, charter operators carried mainly tourists from Western Europe, and these operators accounted for about 7 per cent of total tourist arrivals to the country. Most of the charter flights operate to Sri Lanka seasonally and most of them do not operate continuously year after year, except very few such as Balair, Lauda, Air Monarch, Air Europe and Condor (which has started operating scheduled flights from 1997).

Non-scheduled services have played an important role in meeting increased demand for air cargo when scheduled services have been unable to meet the demand. They have also enabled carriers to develop new markets particularly to places not served by scheduled services.

Table 4: Tourist Arrivals by Charter Carriers, 1996-2001

Charter	1996	1997	1998	1999	2000	2001
Condor	3651(a)					
Balair	2667	4218	4293	3117	3624	976
Sterling Airways						
FinAir				594	1623	
Scan Air						
Lauda	1722	1527	1737	3771	246	715
Air Europe	3507	4197	4983	6282	3747	1360
Air Holland		3199	12831	13584		
Austrian Airlines	414	2499	1734	2121	1728	
Caledonian		2736	4449			
Sobel Air					3369	
Britania	144					
Air Monarch	2952	2781	9893	15606	11607	5586
Air Charter		219	1875			
Others		264	195	834	1923	871
Total	14643	19555	42755	45522	28260	11236

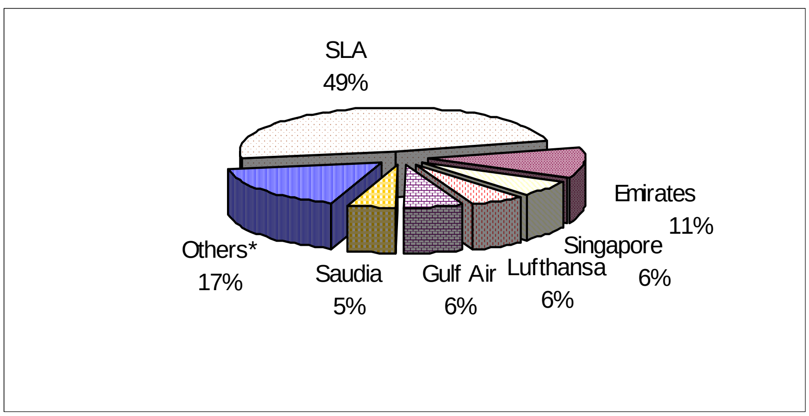
Note: Operating as scheduled airline effective 1997.
Source: Sri Lanka Tourist Board, 2001.

5.2 Cargo (Freight and Airmail)

Sri Lanka completely liberalized cargo transport in 1991, thereby removing constraints imposed upon capacity, frequency, routes, uplift and discharge of cargo, as long as the freight operator met set standards of safety. Following the liberalization of cargo, freighters have added more capacity and frequency and eased the situation but capacity remains a problem as a number of scheduled airlines have been pulling out of Colombo. Prior to liberalization, there was a backlog of cargo as there were constraints to carriage of cargo and rates were well above tariff rates set. Freighters have been operating to ease congestion as a last resort and in some cases, the government even had to offer subsidies to operate these cargo freighters (Aponso, 2002).

In 2002, there were seven dedicated freighters operating to and from Sri Lanka, including three local operators (SriLankan Airlines, ExpoLanka Ltd and AirLanka International Ltd). Although SriLankan Airlines accounted for approximately 0.17 per cent of the total world freight tonne-kilometres performed in 1999, it handled nearly 49 per cent of total freight-tonnes carried to and from Sri Lanka. Other important freight operators include Emirates, Singapore, Lufthansa, Saudi, Gulf Air, etc. Emirates, Lufthansa, Korean Air, China Airlines operate dedicated freighters to and from the country. However, the majority of airfreight is carried in the belly holds of passenger aircraft. In 2000, only 13-14 per cent of air freight was uplifted by freighters, while the majority of airfreight was carried on scheduled carriers. The share of air freight carried on freighters have increased, with the reduction of passenger aircraft capacity due to airlines terminating their services.

Figure 8: Freight Market Share by Airline, 2000



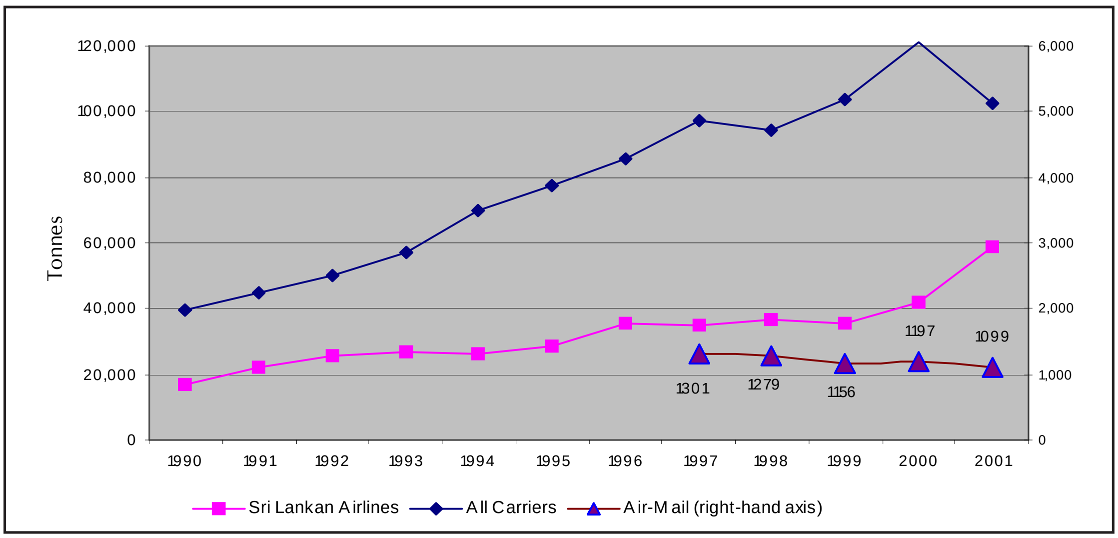
Note: * Other freight operators include Korean Air, Cathay Pacific, Kuwait Airways, LTU, Thai Airways, China Airlines.
Source: Aponso, 2002.

SriLankan Cargo (SLC) has long been the main cargo network into and out of Sri Lanka. SriLankan Cargo has now logged its 1,000th dedicated freighter service flight, after launching the freighter service in September 2000. SLC operates one Antonow AN-12 aircraft between Colombo and a host of South Asian destinations - Gan and Male in the Maldives, Karachi in Pakistan, and Bangalore and Trivandrum in India. It has even operated services to Bangkok. The freighter service complements regular flights, with cargo from the subcontinent being transshipped through Colombo to Europe, the Middle East and the Far East on the airline's passenger aircraft. The freighter service had been of immense help to Sri Lanka's export industries. It carries every type of cargo from fabric and garments for Sri Lanka's ready-made garment industry, to computers and computer parts out of India, to vegetables, fruits and meat to the Maldives, and betel leaves to Karachi.

Apart from SLC, there are two other domestic operators - AirLanka International Ltd (not affiliated to SriLankan Airlines, which was formerly called Air Lanka), and ExpoLanka Ltd. Airlanka International Ltd has been operating a cargo flying service between Dubai, India and Pakistan. It intends to operate cargo services from Colombo to Male too and has applied for a licence for passenger services. Other domestic airline operating at the moment is Expo Aviation, which carries cargo mainly to destinations in the Gulf.

Sri Lanka's international airfreight market has grown rapidly in recent years. The tonnage of airfreight transported in and out of Sri Lanka has approximately trebled in the past decade (Figure 9). Total freight carried to and from Sri Lanka has increased at an annual average rate of 14 per cent from 1990 to 2001, except for two years, in which growth recorded a negative figure. The highest annual growth rate was recorded in 1994. In 1990, total freight tonnes carried to and from Sri Lanka amounted to 39,830 tonnes and the 100,000 tonne mark was passed in 1999. This figure reached 101,638 tonnes in 2001. Growth potential of airfreight depends upon the performance of export and import sectors of the country. There may be possibilities to develop domestic cargo service if the security situation in the country returns to normalcy.

Figure 9: Total Cargo* From and To Sri Lanka, 1990-2001

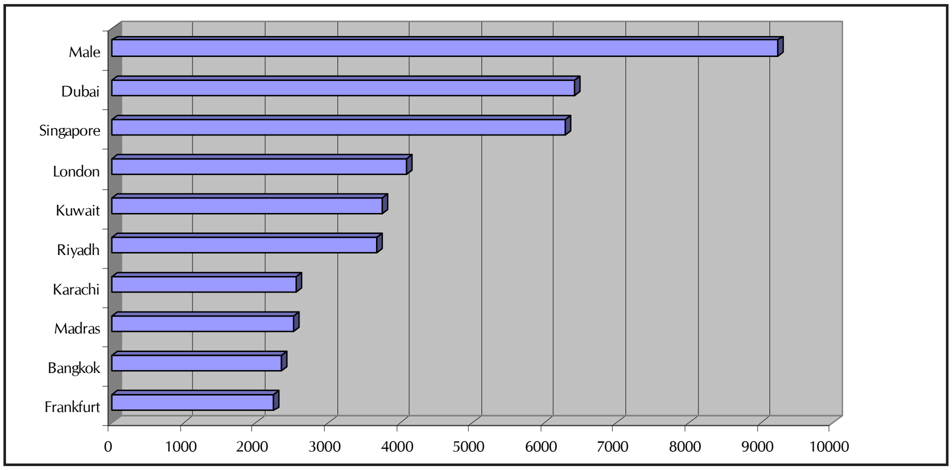


Note: *Cargo includes both airfreight and airmail.
Disaggregated data for airmail is available only from 1997.

Source: Department of Civil Aviation and SriLankan Airlines Annual Reports, 1998/99, 2000/01.

The highest share of outbound airfreight goes to Male, which accounts for approximately 15 per cent of Sri Lanka's total outbound airfreight (Figure 10). Cargo to Male consists mainly of vegetables, fruits, and meat. Top ten cities, ranked according to the number of airfreight tonnes carried from Sri Lanka, accounted for nearly 70 per cent of the total outbound airfreight traffic of the country. There is high concentration over few markets despite the fact that there are freight services to 30 destinations worldwide. Apart from Male, Singapore and Dubai are two very important destinations for both inbound and outbound freight traffic. Singapore and Dubai are important transshipment hubs in the region. Cost considerations (better rates) and lack of capacity, reliability of services and lack of direct freight services to North America from Sri Lanka have contributed to their rise.

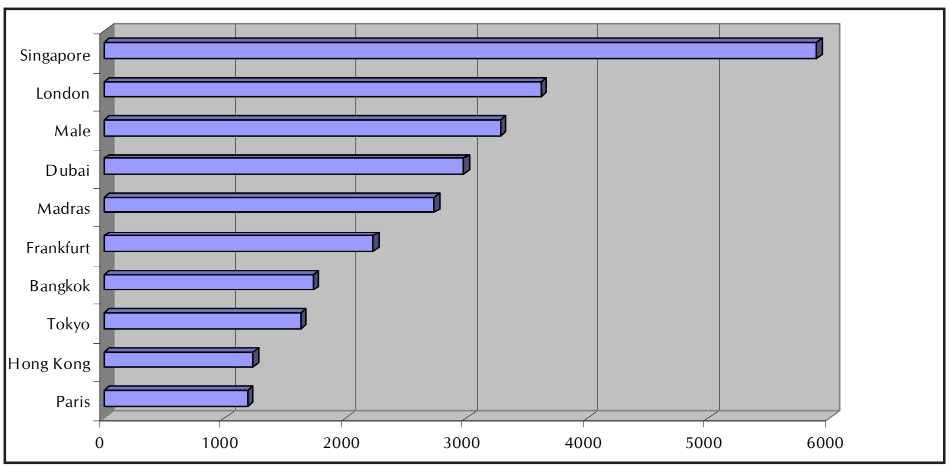
Figure 10: Freight (Tonnes) from Sri Lanka to Top Ten Cities, 2000



Source: Compiled from data provided by the Department of Civil Aviation.

Singapore has become the main source for inbound freight traffic, in terms of total airfreight tonnes carried to Sri Lanka (Figure 11). In 2000, over 5,800 tonnes were carried to Sri Lanka from Singapore. This accounted for 17 per cent of the total inbound airfreight to the country. Top ten cities accounted for nearly 74 per cent of the total inbound airfreight traffic.

Figure 11: Freight (Tonnes) from Top Ten Cities to Sri Lanka, 2000



Source: Compiled from data provided by the Department of Civil Aviation.

The composition of freight consists of a mix of vegetables, apparel and general cargo. Garments accounted for 30 per cent of total uplift (mainly to the US and Europe), followed by fruits and vegetables accounting for 28-32 per cent (destined to the Middle East and Male), betel leaves (10 per cent) to Pakistan, and plants, cut flowers and ornamental fish to Europe, USA, the Middle East and the Far East. Although the tonnage uplifted is quite small, these commodities are high in value.

Airmail transportation has declined in terms of airmail tonnes carried to and from Sri Lanka over the past few years (Figure 9). This is in keeping with the trend around the world, with the rapid development of the telecommunication sector, internet and e-mail facilities, which has led to a fall in the amount of mail carried by air. From 1997 to 2001, mail traffic to and from Sri Lanka has dropped approximately by 8 per cent. Relative share of airmail as a per centage of total freight is around 1 per cent in 2001, both in and out of Sri Lanka. Larger share of the outbound airmail traffic is handled by foreign carriers. In 2000, foreign carriers handled 72 per cent of outbound airmail traffic.

6. Policy Options for Liberalization

There is increasing pressure to liberalize with the global push for more liberal aviation agreements. Bilateral, reciprocal open skies agreements are spreading. If Sri Lanka does not move rapidly, the rest of the world could liberalize around it. Sri Lanka would be disadvantaged if air transport services between other countries become relatively more efficient. Further, the Sri Lankan carrier would be at a disadvantage in expanding its markets if other markets are liberalized ahead of us.

There are a number of policy options for air transport liberalization. These include:

- Unilateral Liberalization
- Bilateral Liberalization: renegotiate bilateral agreements to incorporate provisions such as open route exchanges, multiple designation, capacity freedom, pricing freedom, open third and fourth freedom rights and so on. The benefit of this type of approach is that it brings about a degree of uniformity into the existing disparate system of agreement without disrupting the basic structure
- Lead Sector Approach: Specific markets such as cargo are liberalized, which could provide a basis for subsequent liberalization of other services
- Plurilateral liberalization: of air transport amongst like-minded states, with the option open for non-members to join by agreeing to the terms in place. This would allow like-minded countries to come together fairly quickly and avoid forcing reluctant states into a rapid change in policy. The latter could join whenever they feel it is appropriate
- Multilateral Liberalization: This would have to go through the framework of a multilateral trading organization such as the World Trade Organization (WTO) and be in line with existing multilateral trading principles such as the Most Favoured Nation (MFN) principle whereby a member state would be compelled to allow the same level of access in the aviation sector to all member states equally and unconditionally.

However, before we examine these options in detail, it is important to bear in mind the difficulties that exist in trying to liberalize the aviation market in a developing country as opposed to the highly developed aviation markets of advanced nations such as the United States and the EU. The guiding principle of any changes to civil aviation regulation should be to ensure that Sri Lanka's active participation in the international civil air transport system should not be undermined in any way. As the economies of the world forge ever-closer links with the process of globalization, regular and reliable air transport links are absolutely vital for the continuing competitiveness of the Sri Lanka economy in the global marketplace. However, the market place does not guarantee adequate and sustainable air services; even in industrialized countries, state intervention has been necessary to ensure that public interests are protected and reliable services are available. It has been recognized that 'Given the disparity in size, stage of development and competitive strength between states – particularly the competitive disadvantage faced by many developing country carriers – there needs to be appropriate safeguards in place so that economic liberalization results in fair competition for all participants. Such safeguards ensure that all States can participate in international air transport in an effective and sustained manner' (Rattray, 2002). In fact, multilateral organizations such as the WTO and the ICAO have come to recognize the need for "special and differential" treatment of developing countries in terms of air services liberalization.

The liberalization of aviation policy is widely considered to be perhaps one of the most difficult components of global free trade. Given that global aviation policy is intricately defined and interconnected through over 3500 bilateral air services agreements, any wholesale change risks unraveling the current status quo which is based on fair and equal opportunity for all parties concerned. This is precisely why, the WTO adopted only 3 ancillary services of the aviation industry in its 1994 GATS framework. The WTO realized that applying its MFN (most favoured nation) principle to air services would only serve to undermine cooperation in liberalizing air services between like-minded states. As the IATA has noted, "aviation rather than trade interests should continue to play the predominant role at state level" (IATA Discussion Paper, 1999).

6.1 Unilateral Liberalization

Unilateral liberalization of domestic aviation markets has been pursued in many countries; for example, domestic aviation was deregulated in the US in 1978 and in the EU in the late 1980s to reduce restrictions and promote competition. Privatization of government owned airlines has been a significant unilateral initiative by many countries, which began in the 1980s. Sri Lanka privatized its national carrier, Air Lanka more recently as 1997, with the sale of 40 per cent of the airlines to Emirates. Sri Lanka has undertaken most of its trade liberalization on a unilateral basis but would it be equally advantageous to pursue unilateral liberalization of international air services while the bilateral system persists worldwide?

Under a policy of unilateral liberalization, Sri Lanka would remove current constraints on traffic rights and allow airlines of other countries to supply air services to and from Sri Lanka, without requiring similar rights for Sri Lankan carrier in return. Under this option, Sri Lanka would cease to renegotiate or negotiate new bilateral agreements and would rely on the rights currently available for the national carrier.

Those who advocate a liberalization of aviation policy argue that the current policy is restrictive, giving undue weight to the interests of the national carrier, SriLankan Airlines at the expense of the tourist industry and the country. They charge that protecting the commercial interests of Sri Lankan airlines has restricted foreign airlines' operation to and from Colombo, though the national airline has been unable to meet the growing traffic demand. They argue that to get a seat to Colombo has become virtually impossible because of the constraints the government has put in place on international airlines coming into the country. As such, they suggest that the government should overhaul its aviation policy and open up the island's airspace to encourage major airlines to resume their operations and launch new services to Colombo. They argue that unilateral open skies policy can introduce competition into Sri Lanka's air transport industry and thus enhance the country's competitiveness as an air hub. They also argue that ground handling charges and cost of fuel are high at Bandaranaike International Airport, and these are deterring foreign airlines from operating to and from Colombo. They are of the view that airport utility services should be made more competitive to complement the liberalization of air services in order to attract more airlines to fly to the country.

On the other hand, there is SriLankan Airlines, which is not against open skies *per se* but argues it should be pursued on a reciprocal basis.[15] It argues that opening Sri Lanka's air market will not

[15] We (SriLankan Airlines) are not against an 'open skies' policy at all and would welcome such a move by the Government of Sri Lanka, providing that it is based upon reciprocity. We do not believe however that the introduction of an 'open skies' regime in Sri Lanka alone, will lead to a large increase in foreign airlines operating to Colombo. Today for example there are 57 bilateral air services agreements signed between Sri Lanka and other countries, yet only 15 of these are used by foreign airlines' (SriLankan Airlines, 2001/2002, 3).

necessarily bring in more airlines to the country. An airline would normally fly to a country if an air service operation is commercially viable and not otherwise. It points out to the fact that though Sri Lanka currently has 58 bilateral air service agreements with other countries, only 21 are in use. While foreign carriers have the right to operate to and from Colombo, many are not making use of the bilateral air services agreements because the market is not big enough to make such flights commercially viable. In the past, there was not enough traffic throughout the year due to the domestic situation in the country, which made tourist arrivals erratic and unpredictable, and as a result some of the operators had reduced their frequencies to Colombo or even terminated their operations. In fact, some of the major European airlines have pulled out of Colombo in the past due to inadequate load factors. Currently, there are no major European carriers serving Sri Lanka and this is a problem, as the majority of the arrivals to the country are from Western Europe. The development of robust aviation relationships with countries in Europe will continue to be an important factor in Sri Lanka's international air transport links. The growth in visitor movements from these countries must be matched by increasing opportunities for airlines to serve the markets, without undue restrictions on their ability to do so.

The fact that more than half of the ASAs remain unutilized at present indicates that it is not the lack of capacity, which is constraining the flying of more airlines to Sri Lanka but rather the lack of demand to travel to and from the country. Capacity provided has always been greater than what is being utilized. Thus, capacity has not been a constraint to expansion of services and influx of passengers to the country. Given that there is inadequate traffic generated, unnecessary liberalization of air services, could lead to a situation whereby capacity would be dumped and operators would compete for a given number of passengers through lower prices, sometimes priced below operating costs. This could lead to a situation whereby reputed carriers would pull out of the market. There have been instances in the past where there was excess capacity on some of the routes, which led to a number of reputed European airlines pulling out of Colombo, as other airlines, mostly Middle Eastern airlines operated on a non-commercial basis – that is, to fly the flag of the country for prestige - by pricing far below their operating costs. This had an adverse implication on the country and particularly the tourist industry, which depend on markets in Europe for tourists. While open skies could lead to greater competition, it should be *managed* in order to ensure that there is a level playing field and avert uncompetitive behaviour by particular airlines. This is why many feel that unilateral liberalization is not the solution for Sri Lanka, for such a policy calls for a very strong and established regulatory framework to prevent anti-competitive behaviour from foreign airlines who have the resource base to absorb any short term losses. It is unlikely that Sri Lanka could therefore maximize the benefits of liberalization in the long term if it followed a purely unilateral process.

Moreover, Sri Lanka enjoys considerable bargaining power because of the bilateral system, which it does not enjoy in other international trade agreements. Under unilateral liberalization, Sri Lanka would relinquish its bargaining power and thereby allow other countries to have unconstrained access. The airlines of other countries stand to gain an increasing share of traffic to and from Sri Lanka, while the national carrier would not necessarily be able to expand its own service elsewhere. As such, international rights for the national carrier would become 'frozen' in time if Sri Lanka liberalizes unilaterally, as long as the bilateral system governing international air travel exists. *Sri Lankan carrier would be severely disadvantaged under a policy of unilateral open skies.* It is unlikely to share in the market growth by increasing capacity and frequency and it would be unable to expand its network to include new destinations. The quantity and range of flights from Sri Lanka to foreign destinations would be governed by airlines of other countries. Sri Lanka's bilateral partners will be able to control capacity and frequency on the Sri Lankan routes. They would be able to control entry and stifle competition not only of their own carriers but third carriers as well. It is possible that SriLankan Airlines may become an ineffective competitive force enabling airlines from bilateral partners. The quantity would and range of flights from Sri Lanka to foreign destinations would only increase if airlines of other countries permitted this to occur. With the bilateral system in place, Sri Lanka's bilateral partners will be able to control capacity and frequency on the Sri Lankan routes. They would be able to control entry and stifle competition not only of their own carriers but third carriers as well. It is possible that if SriLankan Airlines were no longer an effective competitive force, airlines from bilateral to reduce the level of services and thereby increase prices. Although Sri Lanka could retreat from its unilateral liberalization policy, the damage to the national airline would be substantial and irreparable with little or no benefit to the consumers.

Users of air services would benefit from a policy of unilateral 'open skies' if it led to greater quantity and range of services and lower prices or if foreign carriers were more efficient and generated effective competition. However, unilateral liberalization of scheduled international passenger services cannot ensure that these changes would take place. Unilateral liberalization would not significantly improve the operating efficiency of the home-carrier, which would have to cut its service quality, flight frequency and other supporting requirements to weather competition. This would have an uncertain impact on consumer welfare and the overall economy in the long-term. A possible outcome would be that consumers who would have preferred to use the national airline but are now unable to do so would bear the cost of having to use less efficient or less preferred carriers.

Like other countries, Sri Lanka should have 'fair and equitable' opportunities and unilateral liberalization could put this fundamental principle at risk, which could not only frustrate the healthy expansion of Sri Lanka's aviation industry, but could also adversely affect the home carrier and Sri Lanka's long term plan of developing as a major regional aviation hub. In order to promote the interests of Sri Lanka as a whole, it is important to recognize that the interests of the home-carrier is an essential part of the entire aviation industry of the country.

If Sri Lanka is to develop as a hub, it is essential to have a strong home-carrier; weakening the home-carrier would put at risk the possibility of turning Colombo into a hub. A strong home-carrier is important for enhancing the country's air hub position for the following reasons:

- only a strong home-carrier can expand trunk routes and extend network efficiently for Sri Lanka;
- a dominant home-carrier, with its headquarters located in the home base, has a much stronger linkage and multiplier effect in the local economy than foreign carriers;
- a strong home-carrier will be more valuable as a member in global aviation alliances;
- a strong home-carrier can maintain a stable supply of air transport services for the hub. This would prevent disruption of services due to political and other crisis situations. Particularly in the case of Sri Lanka, being an island nation, airline services are important to connect the country with the rest of the world. Following the BIA attack in July 2001, it was SriLankan airlines which continued to operate to and from Colombo, whereas all other major airlines serving Colombo pulled out as result of insurance premiums increasing exponentially. Foreign airlines are interested in operating services to Sri Lanka as long as the situation in the country remains stable but theywould be unwilling to take risks by operating at a time when there is uncertainty. With normalcy and peace returning to the country, foreign airlines, which suspended their services following the BIA attack, have resumed their flights to Colombo;
- a strong home-carrier brings "national" prestige to the home base.

Unilateral liberalization would not turn Colombo into an aviation hub in South Asia, as access to the rest of South Asia depends on the extent to which skies are liberalized in the region. Up to recently, India has been protective of its aviation industry and access to the Indian market by foreign airlines. An example is the restrictions imposed by Indian authorities on the number of frequencies and destinations in India that Sri Lankan airlines could fly. However, the stance of the Indian authorities may be changing.

India has offered Sri Lanka the facility of additional daily services for SriLankan Airlines between Colombo and its six major metropolitan hubs (access to be restricted to 7 flights a week). In addition, it has expressed willingness to offer unlimited access to 18 other regional airports. India's private scheduled airline operators (Sahara Airlines, Jet Airways) have been allowed to operate into Colombo in addition to Indian Airlines, as India pursues liberalization of its aviation policy. Further liberalization of the Indian aviation market is highly desirable for Sri Lanka and India alike. In fact, the Indo-Lanka Comprehensive Economic Partnership Agreement (CEPA) Report prepared in November 2003 by a committee appointed by the prime ministers of the two countries has identified aviation as one of the areas of further economic cooperation. The CEPA moves beyond the Indo-Lanka Free Trade Agreement (ILFTA), which is limited to liberalization of trade in goods between India and Sri Lanka, and covers a very wide spectrum of trade and economic areas including services. The agreement in general allows the two countries to enter into broad negotiations covering all service sectors and modes of supply within the GATT framework. The implementation of the CEPA is expected to 'take the two countries to a qualitatively new level of engagement by intensifying and deepening bilateral economic interaction.'

Opening Sri Lanka's skies unilaterally to foreign carriers will not result in Colombo emerging as a hub. As long as the rest of the world remains committed to the bilateral system, the extent to which Sri Lanka would benefit from a policy of unilateral liberalization would depend on how its partners behave. Under a unilateral liberalization policy, Sri Lanka could be worse off than if it continued to negotiate additional capacity on a bilateral basis. As such, it is necessary for Sri Lanka to enter into a series of differing but reciprocal agreements with other countries in order to maximize the gains for the airline and the country.

6.2 Reciprocal Bilateral Liberalization

One option for liberalization of Sri Lanka's air services would be to accelerate the process of liberalization by negotiating bilateral 'open skies' agreements on a reciprocal basis. The aim of a reciprocal open skies policy would be to remove restrictions in the ASAs on competition between airlines of Sri Lanka's and its bilateral partner. Under a bilateral reciprocal open skies agreement, Sri Lanka would only remove current restrictions if the bilateral partner also agrees to remove constraints on the Sri Lankan carrier. Much could be achieved by liberalizing on a reciprocal basis with other countries, *bilaterally than unilaterally*.

Under a reciprocal open skies agreement, airlines would be better able to react to the market and new opportunities. Airlines will be faced with greater competition and would be forced to reduce their costs as well as develop their markets to remain ahead of competition. Consumers and other users would benefit from greater capacity and frequency, expanded networks and competitive fares. The costs to the governments and airlines of maintaining agreements would be also reduced.

Sri Lanka signed an open skies agreement with the US in October 2001. It is the second Open Skies agreement to come into force with a South Asian country, Pakistan being the first in 1999. Under the Open-Skies aviation agreement all restrictions on air services to, from and beyond each other's territory will be removed. Open-Skies agreements eliminate restrictions on how often carriers can fly, the kind of aircraft they can use, and the prices they can charge. The agreement covers both passenger and cargo services, as well as scheduled and charter operations.

Most elements of the US-Sri Lanka open skies deal will take place immediately, with others to be phased in. Pricing liberalization will take effect from December 31, 2004, passenger charter liberalization from December 31, 2006, and the ability of U.S. carriers to provide their own ground handling services in Sri Lanka from March 31, 2008. In addition, U.S.-carrier Sri Lanka passenger service involving a stop in India may carry local traffic between India and Sri Lanka only after December 31, 2006. The US-Sri Lanka Open

Skies Agreement could provide a template for a possible open skies policy for Sri Lanka with other countries.

A policy of reciprocal open skies policy would include the following factors:

- Unrestricted third and fourth freedom rights are important as a means of encouraging competition between designated carriers. It allows for designated carriers to compete on a more rigorous basis for market share. Together with multiple designation, it also represents an important means of allowing entry by new carriers. Negotiating capacity on a 50/50 basis under the current agreements, restricts the ability of carrier/s of one country to take the market share away from the carrier of the other country. The result is that high cost carriers can be protected from lower cost bilateral carriers. Together with multiple designations, unrestricted third and fourth freedom rights also allow the entry of new carriers and provide greater competition.

- Binding constraints on third and fourth freedom capacity between two countries can have the unintended effect of weakening the competitive position of the carriers of the two countries to the advantage of third country carriers, if capacity limits fail to keep up with growth in the market. Removal of capacity constraints could improve the competitive position of bilateral partners against third countries.

- Sri Lanka should seek to negotiate reciprocal 'open skies' agreements on a bilateral basis.

- Given that the current bilateral system of air services agreements is likely to be in place for sometime, *Sri Lanka should pursue liberalization within a bilateral system.*

- An open skies policy will allow market forces to prevail and determine the frequencies of services that an airline will provide.

- Sri Lanka should seek to remove single designation in the country's aviation policy.

- Open skies policy should be pursued on a case-by-case basis and should not be driven by ideological reasons or by designer label policy. Sri Lanka should conclude bilateral open skies policy with countries, which are potential markets for tourism, trade and investment. The current tourism policy of the country is to attract more visitors from within Asia, namely visitors from India, China and the Far East while continuing to promote tourism from the traditional markets in the West. Open Skies agreements could be initiated with these countries in order to promote tourism to the country. Some countries which already have open skies policies with other third countries would be more prepared to enter into an open skies policy arrangement with Sri Lanka and these countries provide a starting point. These include UK, Australia, Singapore, Malaysia, UAE etc. Achieving the best results from bilateral 'open skies' agreements will require careful attention to strategic sequencing of negotiations with various countries. Sri Lanka should try and sign open skies agreements with countries that have the most incentive to sign such agreements. A number of countries may not be prepared to liberalize their ASAs to the extent of negotiating bilateral reciprocal 'open skies' agreements. In such a case, Sri Lanka should renegotiate ASAs as much as to remove restrictions. Such reciprocal agreements should also contain restrictions on government subsidies where these are substantial.

- Moving from a 'positive list' of restrictions in agreements to a 'negative list', whereby all forms of trade is allowed unless specifically excluded, would provide a fast track process towards liberalization. The negative list approach has a number of advantages and it is the preferred means of negotiation. First, any new form of trade is automatically included in the ASA without the need for negotiation for its inclusion. Second, its easier to negotiate on the removal of restrictions than to negotiate for addition of rights. Third, it is in keeping with the GATS agreement.

6.3 Plurilateral Liberalization

However, bilateral liberalization can only go so far. In order to fully develop a global airline network, a concentrated international effort is needed. There is a proposal to form an open club based on common 'open skies' agreement among a group of like-minded countries. This would allow all carriers within the group to fly freely among the members, subject to a common set of rules. The agreement would be best based on a 'negative list' approach. It should be open to other countries to join on the same conditions. A regional approach, which is closed to non-members would encourage competition within the group at the expense of market access for non-members. The challenge would be to ensure that such a regional agreement is used as a stepping stone to global liberalization rather than as a means of favouring the members only. Thus, openness is an important feature of such agreements.

A common agreement would be simpler than a complex set of reciprocal bilateral agreements. Progress towards an open club could be achieved by negotiating separately similar liberal agreements among a series of partners, but this is likely to be too time consuming and complex to achieve compared to a single plurilateral agreement. The benefits to members would grow in proportion to the size of the network, while the opportunity cost of not joining would also grow. Non-members would risk becoming isolated from the increase in traffic in response to the more liberal conditions available within the club. With respect to Sri Lanka, a plurilateral option available is to pursue such a course of action within the regional groupings that it is a member of including SAARC, BIMST EC and the IORAC. The chances for regional cooperation in air travel are looking more promising than they have done for a long time. The climate for such a policy change is getting better especially within the SAARC region with the Indian government going to significant lengths to liberalize its aviation sector and related services and allowing Pakistani airlines to use its airspace after a lapse of over 2 years.

The EU and the APEC forum are two models for establishing a collective approach to international air services in a specific region. The EU as part of its broad, single market reforms, has transformed the once separate bilateral aviation markets of its members into a single, liberal aviation market that is open to all airlines from EU member states. The Asia Pacific Economic Cooperation (APEC) forum provides another model for establishing a collective approach to international air services. A plurilateral aviation agreement involving the US and six other nations, including one non-APEC economy provides airlines of these countries the opportunity to operate more freely than under bilateral agreements between one another. The effect has been to create a large open aviation market. Significantly, the agreement is open to accession by both APEC and non-APEC economies.

6.4 Multilateral Liberalization

Ultimately, a liberal multilateral agreement under the WTO which covers all or most countries would allow international air services to develop in response to market pressures. Efficient carriers would replace inefficient carriers and removal of regulatory barriers to entry would enhance competition. It would be easier to administer and comply with than the current bilateral system.

Given the entrenched nature of the bilateral system in existence, and the difficulties of negotiating a truly liberal multilateral agreement, reciprocal bilateral and plurilateral liberalization options may be the best ways of achieving gains in the short-medium term. The difficulties in pursuing multilateral liberalization were highlighted earlier and to date, there seems to be no real consensus on how to carry out such a monumental task. However, the experience of the international telecommunications agreement illustrates that countries can move quickly to achieve a multilateral and liberal agreement when they realize the advantages.

7. Airport and Ancillary Facilities

If Sri Lanka is to turn Colombo into airport hub, it is imperative that logistics, infrastructure, support services and capacity are improved to international standards (Aponso, 2002). A modern airport has become indispensable to a country's development, let alone the aviation industry. Sri Lanka has a geographical advantage to emerge as an aviation hub due to air routes crossing over Colombo. Known as 'airways' these routes are the best way for aircrafts to fly from east to west and north to south.[16] In fact, Colombo served as a transit point for many airlines mainly for refueling purposes until 1970s but lost its importance with the advent of aircrafts, which were able to fly further without having to stop for re-fuelling. Sri Lanka because of its inherent advantage has a potential to be a hub airport but there are many challenges that need to be overcome.

Table 5: Terminal Capacity and Forecast Movements

Year	Historic Passenger Movements (Million)	Forecast Terminal Passenger Movements High Growth (Million)	Capacity (Million Pax)	Forecast Annual Increase
1996	2.149		3.0	7.9%
1997	2.319		3.0	9.7%
1998	2.366		3.0	2.0%
1999	2.649		3.0	12.0%
2000	2.880		3.0	8.7%
2001	2.628		3.0	-8.8%
2002		2.88	3.4	9.5%
2003		3.15	3.4	9.5%
2004		3.45	5.0	9.5%
2005		3.78	5.0	9.5%
2006		4.12	5.0	9.1%
2007		4.50	5.0	9.1%
2008		4.91	5.0	9.1%
2009		5.35	5.0	9.1%
2010		5.84	5.0	9.1%
2011		6.35	5.0	8.7%
2012		6.90	5.0	8.7%
2013		7.50	5.0	8.7%
2014		8.15	5.0	8.7%
2015		8.86	5.0	8.7%
2016		9.60	5.0	8.3%
2017		10.39	5.0	8.3%
2018		11.26	5.0	8.3%
2019		12.19	5.0	8.3%
2020		13.20	5.0	8.3%

Source: Steering Committee on Airports & Ports Development, 2002.

[16] Many of air routes converge over Colombo including the M300 air corridor, taking aircraft from Singapore to the Middle East and on to Europe, and P570 from Indonesia to Jeddah taking Haj pilgrims. These along with one from Madras are among the busiest but new air routes are being planned, including one south of Trivandrum. They are expected to ease the current congestion, which peaks from late December to mid-March each year. During the three-month period, there are upto 70 of over-flights a day crossing Sri Lankan airspace (Financial Times, 2001).

Table 6: Cargo Capacity and Forecast Cargo Movements

Year	Historic Cargo Movements (MT)	Forecast Cargo Movements High Growth (MT)	Cargo Capacity (MT)	Anual Increase
1996	84719		100000	13.7
1997	97436		100000	-3.2
1998	94364		100000	10
1999	103810		150000	23.9
2000	128316		150000	-20.9
2001	101547		150000	14.3
2002		116068	150000	14.3
2003		132666	150000	14.3
2004		151637	150000	14.3
2005		173321	250000	14.3
2006		196200	250000	13.2
2007		222098	250000	13.2
2008		251415	250000	13.2
2009		284602	250000	13.2
2010		322169	250000	13.2
2011		364696	250000	13.2
2012		412835	250000	13.2
2013		467330	250000	13.2
2014		529017	250000	13.2
2015		598848	250000	13.2
2016		672506	250000	13.2
2017		755224	250000	13.2
2018		848117	250000	13.2
2019		952435	250000	13.2
2020		1069584	250000	13.2

Source: Steering Committee on Airports & Ports Development, 2002.

For Sri Lanka to attract more airlines to the country, and to emerge as a hub, it has to become attractive 'cost wise, and in terms of facilities and quality of service'. Currently BIA lacks both modern facilities and capacity to meet the demands of increasing passenger and cargo traffic. According to a Steering Committee on Airport & Ports Development, passenger numbers and cargo movements were expected to grow in the region of 8-9 per cent and 13-14 per cent a year, respectively until the year 2020. A comparison of the existing capacity with forecasts revealed that by 2004. BIA will not be able to cope with both passenger and cargo traffic demands during peak hours with its present capacity (Table 5 and 6). The airport currently has a terminal capacity of 3.4 million a year and cargo capacity of 150,000MT. BIA handled about 2.6 million passengers and 101,547 MT of cargo in 2001. By 2010 this is projected to increase close to 5.84 million passengers and 322,169 MT of cargo and again to double more than 13.2 million passengers and 1,069,584 MT of cargo by 2020. The present facilities at BIA are far below what is necessary for the airport to qualify for the status of a hub or a modern airport (Box 6).

This is why the government has undertaken a USD 100million project to improve handling capacity and efficiency at Bandaranaike International Airport. The construction was inaugurated on the17 September, 2003 and work is expected to be completed by September 2005. With the completion of this project in the year 2004, the airport would be able to handle 5 million passengers and cargo capacity of 150,000 MT per year with many other improvements in aircraft parking and ancillary facilities (Box 7). The project is funded through a loan from Japan Bank for International Cooperation (JBIC).

Box 6: Existing Facilities at BIA

One Passenger Terminal
Floor Area: 40,000 sq.m
Gate Lounges: 4 plus 2 temporary lounges to meet peak demand
Arrival baggage belts: 4
Peak Hour Arrival/Departure Capacity: 1650 passengers
Annual Capacity: 3.4 million passengers.

Three Cargo Terminals
Cargo facility includes a cargo village operated by the private sector and a cargo complex operated by the ground handler at the airport
Annual Capacity: 150,000 metric tones

Runway and Taxiway
Single asphalt runway (3,350 metres long, capable of handling any aircraft in operation today)
Full length parallel taxiway with 90 degree exit taxiways
Runway – taxiway separation: 200 metres
Capacity: 25 aircraft movements per hour. However at times of peak demand, not more than 5 aircraft can be served per hour due to other constraints.

Aircraft Parking Apron
Parking stands: 17. However, of these 5 cannot be used due to surface damage. 4 are regularly used by SriLankan Airlines and cargo planes for semi-permanent parking.

Car parks
Terminal car park: 350 bays
Remote car park: 320 bays

Source: Steering Committee on Airport and Ports Development, 2002.

The Steering Committee on Airport & Ports Development has also highlighted on the pressing need to simultaneous commence work on further upgrading of the airport (Stage 2) as soon as possible. It can be seen that even with the completion of Stage 1, the airport will only be able to cope with passenger and cargo traffic up to 2008/09. The government and the airport authorities are in a race against time and must not hesitate in implementing the Phase 2 (Box 8) development in order to prevent capacity constraints which could severely hamper BIA's chances of becoming a hub for the region.

Box 7: JBIC funded BIA Development Project – Stage 1

Civil and Utility Works: This includes rehabilitation of southern section of parallel taxiway, improvement of existing concrete apron, widening of exit taxiway and improvements to the water supply, drainage and sewage systems.

Passenger Building Works: This is the most visible of all the contract packages as it includes the construction of a brand new 18,000m^2 pier (with 8 boarding bridges, gate lounges, moving sidewalks, new escalators and screening equipment). It also includes the construction of a new link building, renovation of the existing passenger terminal building and installation of 1,500 kva generator for emergency power.

Cargo Building Works: The main component of Package B2 is the construction of a new Cargo building of approximately 12,750 sq.m. with an annual cargo handling capacity of over 100,000MT in order to meet the growing demand for cargo services.

Air Navigation System: This is the electronic package, which includes the acquisition of new Monopluse Secondary Surveillance Radar (MSSR), Radar Control Equipment, Aeronautical Communication, and Meteorological Observation equipment, which will ensure that BIA will have a state of the art Air Traffic Control system.

Source: Steering Committee on Airport and Ports Development, 2002.

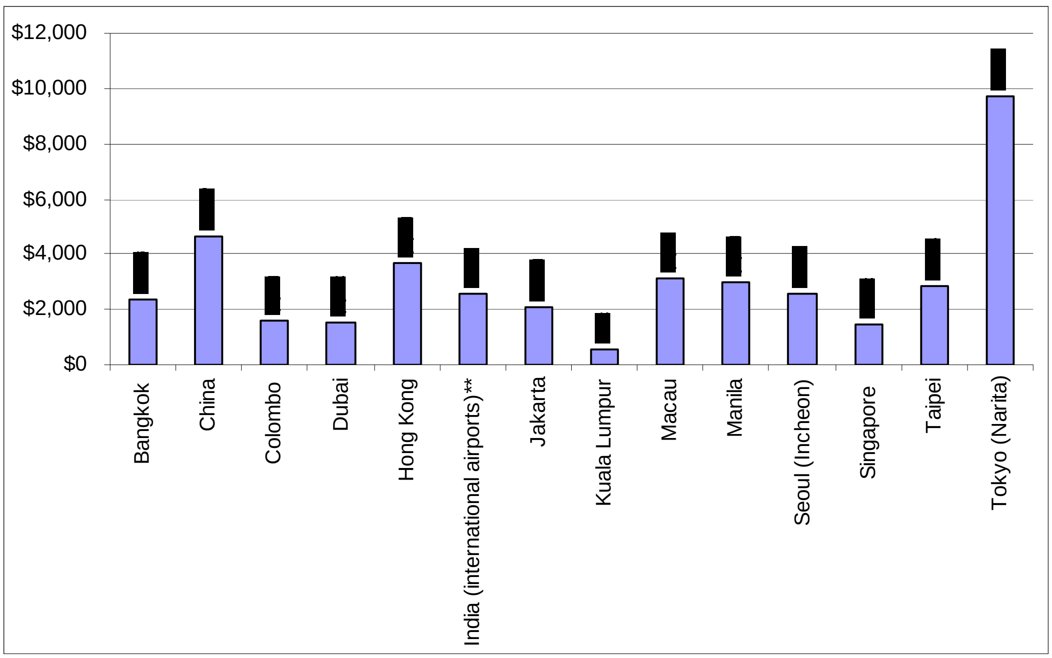
Box 8: Plan for Stage II of Airport Development

- Relocation of SLAF base from BIA
- building of separate terminals for arrivals and departures
- existing terminal to be converted to serve regional/domestic flights and connected to the new terminals by shuttle train/bus
- Construction of an additional parallel runway (1,800 metres apart from the existing runway), with facilities in place for the simultaneous operations of both runways.
- Terminal buildings to contain all facilities to cater to the needs of passengers, including transit passengers as BIA will be a hub aiport
- Facilities will include specialty duty-free shops, beauty salons, health clubs, casinos, computer games, play areas, restaurants, day rooms, toilets with all modern conveniences, child care centre, cultural centre, business centre, swimming pool, spa, gymnasium
- Direct connection to the Katunayake Express Highway to Colombo and Colombo Port
- Construction of a special lane for the exclusive use of container trucks, connecting cargo complex to the Katunayake Express Highway
- Construction of a modern cargo handling complex with facilities for trans-shipment
- Construction of a rail connection to the cargo/terminal buildings
- Construction of a complex for aircraft repairs and maintenance
- Construction of a multi-storey car park

Source: Steering Committee on Airport and Ports Development, 2002.

In terms of cost, it is apparent from Figure 12, that the airport landing and parking charges at BIA are very competitive, being the fourth cheapest after Singapore, Kuala Lumpur and Dubai.[17] It is more than US$1000 cheaper to land a Boeing 747-400 and have a 3 hour turnaround time at BIA than it is at any Indian international airport. It is also worth bearing in mind that both Singapore and Kuala Lumpur international airports have been offering significant rebates to airlines that land there after the devastation caused by the SARS epidemic in an effort to attract lost business. Therefore, this places BIA in a promising position to exploit a liberal open skies arrangement with India, as it could develop as a lower cost hub for airlines to serve the big cities of India. BIA could certainly exploit this cost advantage, as the new airport in Seoul has aimed to do from Tokyo's Narita airport.

Figure 12: Landing Charges (2003) Based on a Boeing 747-400 with 3 Hours Parking Time



Notes: **New Delhi, Mumbai, Chennai, Kolkata, Trivandrum, Ahmedabdad, Bangalore, Amritsar, Guwahati, Hyderabad, Goa and Cochin.

Ground handling and catering are currently monopolies of SriLankan Airlines and they can be a barrier to the provision of these services on a commercial basis. Ground handling and catering should be open to competition, with privatization and divestiture from the national carrier. According to the terms of the renegotiated MOU between the government and Emirates (which has management control over SrLankan Airlines), ground handling at the ramp and catering will be the exclusive preserve of Sri Lankan Airlines until 2008. By restricting cargo handling to SriLankan airlines, the government has lost an opportunity to bring competition into that sector and make BIA an attractive cargo hub for the region. When compared with countries in the region, Colombo airport has one of the lowest cargo throughput rates in the region, slightly higher than Madras (Table 7).

Given the fact that there are three major international airports (Dubai, Singapore and Kuala Lumpur) with top class infrastructure and competitive charges all within 3-4 hours flying time of Colombo, the only realistic chance of BIA developing as a hub would be for the Indian Sub-continent. The Indian

[17] Landing fees are charged according to the weight of the aircraft.

government has expressed plans to develop Bangalore international airport as a regional hub and this could potentially threaten the prospects of BIA becoming a gateway to the rest of South Asia. It will be difficult for BIA to compete unless an open skies deal with the Indians is so flexible that the advantages of flying into Bangalore would be negligible. Needless to say, if BIA does not get first mover advantage in this case, it stands to lose out. Added to this fact is the move by airlines choosing ultra-long haul planes such as the new Airbus A340-500 which are eliminating the need for several stops on long distance routes. Moreover, a vital element in the evolution of a hub airport is the presence of a strong home carrier based at that airport, as we can see from Table 3. Therefore, the government will need Sri Lankan Airlines to continue to grow as a major transporter of passengers and cargo to the region. It would take years and a massive infusion of capital for a commercially viable second airline to develop the kind of route network that SriLankan already enjoys into the Sub-Continent.

The development of a second international airport will become necessary in order to make BIA a regional hub. An alternative airport is necessary at times of bad weather or other emergencies. Presently, the alternative airport to BIA is Chennai, which is over 400 miles away and this means airlines flying into Colombo are required to carry enough fuel in case of an emergency to divert to Chennai according to IATA regulations. This significantly adds to the cost of operating to Colombo. Civil Aviation Authority has suggested that the existing Minneriya SLAF base be upgraded to the status of an alternative airport as the runway is long enough for most commercial airliners and its location means it would not be affected by the same weather system that affect the West Coast.[18] Other possible airports that have been suggested include Matugama, Hingurakgoda, Wellawaya and Angunakolapelessa.

Table 7: Airport Ranking, 2000

Rank	Airport	Total Tonnage
9	Singapore	1705410
22	Bangkok	871000
28	Dubai	581997
32	Kuala Lumpur	524224
35	Sharjah	475122
54	Bombay	304520
64	Delhi	246133
98	Colombo	128385
111	Madras	108242

Source: ACI cited in Aponso, 2002.

[18] The alternative runway has to be in a different climatic zone.

8. Conclusion

This study has aimed to provide a preliminary and comprehensive look at the existing policy options for Sri Lanka in terms of aviation as it looks to cement its age-old position as a link point between other nations. The first section of this study has illustrated the deregulation of the aviation industries in the major markets of the US, the EU and Australia-New Zealand. It is clear that deregulation in all the above mentioned aviation markets has led to considerable price reduction and increased competition which are of great benefit to the consumer. On a global level, a web of inter-governmental agreements for the past 60 years has largely dictated the structure of the industry and the way it operates. These agreements govern which airlines can fly where, how many seats they can offer and even what fares they can levy and far too many governments still remain determined to unconditionally support their flag carriers, hindering efficiency in the industry by protecting weak carriers and restricting competition.

Generally speaking, the industry has been experiencing a difficult period in recent times. It has been hit by terrorism, economic slowdown, war fears and the SARS epidemic in addition to tight regulation. There has never been a more crucial time for the aviation industry and this could be the ideal scenario for profound change in its manner of operations. Although both the US and the EU espouse 'open skies' but regulate only technical and safety rules, they should be true to their word and liberalize flights across the Atlantic, which would set a precedent for most other countries to follow suit. An encouraging sign in this regard is that recently the European Union and the US began negotiations on further liberalizing air traffic across the Atlantic, which will have implications on the rest of the world. Until 2002, negotiations for traffic rights over the Atlantic took place between the US and individual European countries. But in 2002, the European Commission won a court ruling that the arrangement was unlawful on the grounds that the bilateral deal allows only an airline of the signatory country to fly that route, discriminating against airlines from other EU countries. Subsequently, the EU's Council of Ministers voted to give the European Commission the authority to negotiate with the US on a EU-wide basis.

Another important development was the recent cross–border merger between Air France and KLM Royal Dutch Airlines, which indicated the determination of European airlines to consolidate in order to survive. The merger is expected to be more integrated than any other cross-border deal in the industry. Most airline alliances are little more than joint-marketing exercises. Moreover, this will challenge the status quo that exists in the Atlantic aviation market. Cross EU integration was not allowed since the open skies between the US and the European countries only allowed for the terms of the deal to be available to a nominated home carrier of the European signatory. If the KLM-Air France deal proceeds, this would be a major step towards genuine deregulation. Given that the EU and the US account for a significant majority of air travel at present, such a move would send very positive signals to the rest of the world.

As for Sri Lankan aviation policy, the country's future viability as an export driven economy and also its position as a favoured tourist destination depend significantly on a more open and accessible aviation policy. Given the fact that most nations are moving towards some reductions in existing restrictions, it is imperative that Sri Lanka adopts a progressive and liberal policy, which would serve the country's national interest, keeping in line with global developments in the aviation industry.

The government has recognised the important role played by the aviation industry in promoting travel, trade and tourism in the economy. The indications given by the government have been encouraging, and the changes that are pending in terms of airport development, and the adoption of a new civil aviation policy will benefit the country in the long term. Given that industry forecasts that the Asia-Pacific region will soon become the dominant aviation market in the world, Sri Lanka must ensure that it makes use of its strategic location in order to get the benefits that would accrue from the growth of the regional aviation market. Sri Lanka is fortunate that the potentially massive Indian aviation market is at its doorstep and the priority of the government's civil aviation policy must be to ensure a highly liberalized market between Sri Lanka and India to attract tourist traffic and also develop BIA as the key air transportation hub for the South Asian region. The bilateral open skies deal with India, which is in the pipeline, is crucial to the overall development of BIA as a regional hub and its success will greatly influence the role of BIA in the future.

As stated in the report, progressive bilateral liberalization with selected partners initially on a reciprocal basis and the adoption of a negative list approach are the best way forward for Sri Lanka in the short to medium-term until a global multilateral framework for aviation is put in place. The government would be wise not to follow a path of unilateral liberalization when it drafts its future Civil Aviation policy as such a move may not provide the kind of long-term benefits that Sri Lanka should strive to achieve.

There are of course numerous difficulties in achieving the aims of liberalization including the volatile geo-political climate of the South Asian region and also the fairly restrictive terms of the Sri-Lankan-Emirates MOU. Although there is little the government can do to control the wider regional political climate, if and when it renegotiates the MOU with Emirates, it should do all it can to ensure that its liberalization efforts are not totally subordinated to the demands of the national carrier especially in the currently contentious areas of cargo handling and other local airlines being allowed to fly from Sri Lanka abroad.

However, as pointed out by many aviation experts and also mentioned above, the need for liberalization must be tempered with the knowledge that developing countries attempting such policies must ensure the viability of their aviation sectors by having some safeguards for home carriers and a strong regulatory framework to ensure that a competitive environment prevails. SriLankan Airlines plays an extremely crucial role in the Sri Lankan economy by being the primary means of travel to and from the island for tourists and business people alike and it is a well-established carrier with a good reputation. Its importance to Sri Lanka was clearly highlighted in the July 2001 incident so policy-makers will have to strike a delicate balance in order to ensure that while long-term liberalization is the ultimate target, any changes in the short-term would not significantly disadvantage SriLankan Airlines as that would have an adverse impact on the whole economy. Over time, once the local aviation sector matures and there is the expected increase in demand for overseas travel, the government should fully encourage competition for SriLankan Airlines from within Sri Lanka in order to reduce our dependence on one airline.

In the context of adopting a liberal aviation policy, it is also important to recognize the importance of maintaining and strengthening safety and security regulation following the terrorist attacks on BIA in July 2001 and September 11 events in the US and the threat of further terrorist attack. Adequate and effective measures need to be in place to ensure safety and security of international airlines operating to and from Sri Lanka.

As highlighted in the paper, the development of the airport infrastructure and civil aviation facilities need to keep up with the liberalization of air services in order to reap the benefits from liberalization. There is a need to enhance exsisting facilities by expanding terminal and cargo capacity, apron parking spaces, runway/taxiways and other infrastructure to turn BIA into a state-of-the-art airport to become a hub for South Asia.

The future of the global aviation market and of Sri Lanka's role in it is not completely certain given the highly convoluted nature of the aviation market. However, this should not discourage the policy-makers from putting in place a reciprocal bilateral liberalization process as well as the other measures mentioned above as soon as possible in order to ensure that Sri Lanka is well placed to take maximum advantage of future changes to become an important player at the regional level.

Appendix: Major Events in Sri Lanka's Civil Aviation History, 1911-2000

1911	First airplane brought to Sri Lanka.
1934	State Council decides to construct an aerodrome at Ratmalana.
1935	Airplane touches the Ratmalana aerodrome for the first time.
1937	Local Air Navigation Regulations are formulated and three airplanes are brought under the civil aircraft register.
1938	Director of Public Works is appointed to act as a Director of Civil Aviation;Ratmalana Aerodrome is declared open for air traffic.
1939	An emergency landing pad is constructed in Puttalam.
1942	Royal Air Force takes over control of Ratmalana aerodrome.
1946	Department of Civil Aviation is established under the Ministry of Transport.
1948	Sri Lanka becomes a member of the International Civil Aviation Organization (ICAO); Air Ceylon starts operation of scheduled flights to Madras with an intermediate stop at Jaffna.
1950	Air Navigation Act (No. 15 of 1950) is introduced.
1951	Air Ceylon becomes a public enterprise (Act No. 7 of 1951).
1957	The British government hands over Katunayaka Airport to Sri Lankan Government and consequently operation of international flights are shifted to Katunayake.
1961	Domestic air service to Anuradhapura begins.
1979	Air Lanka is born as a public company.
1980	Airport Authority is established.
1982	Offence against Aircraft Act (No. 42 of 1982) is passed in Parliament.
1990	Government decides to liberalize the carriage of cargo by air.
1993	Sky Cabs Ltd. begins operation of international scheduled cargo service with AN-8 aircraft.
1995	Government suspends operation of domestic civilian flights on account of the security situation in the country.
1997	Expo Aviation starts operation of internal cargo service.
1998	Air Lanka is privatized (40 per cent shares are sold to Emirates).
1999	Air Lanka is renamed as SriLankan Airlines.
2000	Department of Civil Aviation cancels the airline licences issued to Sky Cabs Pvt. and Expo Aviation Pvt. Ltd. due to non-compliance with Air Navigation Regulations. Expo Aviation Ltd. obtains airline licence by undergoing complete re-certification process.
2001	Terrorist attack at Katunayake International Airport; SriLankan Airlines loses half of its fleet.
2002	Civil Aviation Authority of Sri Lanka Act No. 34 enacted by Parliament, replacing Civil Aviation Department.
2003	European Association of Aero Space Industry (AECMA) opens a Civil Aviation Authority (CAA) Training Academy for South Asia.

Source: Compiled from information provided by the Department of Civil Aviation.

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