

Consultation Paper 3.1

Support for MCAT in the Negotiation of Bilaterals

Executive Summary

The bilateral system was designed to enable governments to correct any unacceptable imbalances in the effect of competition and thus to protect weaker, or infant, industries.

The system creates traffic rights which have a value, which should not be thrown away.

To facilitate the recovery of Ariana, it should select carefully the routes likely to bring in the greatest revenue most quickly; and the bilaterals should be geared to enable them to do this.

This will require expertise in the techniques possible under the bilateral system; and in route analysis.

TSR recommends the recruitment of two outside experts to help in this process, for one or possibly two years. The cost would be between USD 400,000 and USD 600,000. For this purpose, the government should approach the ICAO Technical Assistance Bureau for suggestions of suitable people and approach donors to see whether funding would be available for which a case might be made.

Recommendations:

Afghanistan should use the opportunities afforded by the system of bilateral agreements which underlies the international aviation system to protect and support Ariana until it is firmly established.

Actions:

Two experts should be recruited to support MCAT in the negotiations of bilaterals for one or possibly two years. MCAT should approach a donor for funding.

Introduction

The draft policy produced by TSR at the end of Phase 1 recommends that Afghanistan use the opportunities afforded by the system of bilateral agreements which underlies the international aviation system to protect and support Ariana until it is firmly established. This paper makes proposals to help MCAT to do this.

The Impact of the Bilateral System

The bilateral system creates traffic rights. That is to say that before any airline situated in country A can operate between A and country B it needs traffic rights to be granted by B. Its own government negotiates these rights on behalf of the airline; and it is possible, and normal, for either government to insist on conditions before the traffic rights are granted. These can range from obligations to settle fares and conditions, to agree schedules, to control capacity, to enter into code-sharing arrangements, to provide facilities and so on. The traffic rights thus have a value and the art of the bilateral negotiator is to realise as much of that value as possible.

At the other end of the scale are the open skies agreements negotiated in the main by the USA. It is instructive to understand how these make use of the principle of traffic rights. In effect the US open skies agreements are an exchange of traffic rights without any restrictions (except of course that the huge U.S. domestic market remains closed). In the case of the U.S., with its large and attractive market, the agreements sacrifice the power to impose restrictions (at least under the bilaterals; its use of the anti-trust rules is a separate issue) in return for:

- A reciprocal sacrifice on the part of the other party. This gives complete freedom to the powerful American airline industry on the routes between the two countries (and sometimes on other routes).
- This usually leads in turn to a highly competitive market with the economic advantages that would normally be expected to derive from it.

In the case of Afghanistan, the freedom to operate without restrictions to other countries would at present be largely academic.

The other countries would provide services as it suited them (and their government) and the consequence would probably be a series of route monopolies operated by third country airlines (assuming of course that they found the Afghan market sufficiently attractive to operate at all). This would not help to re-establish the general Afghan economy. It is very likely that Ariana could not at present compete in such a market. The consequence would be either large and increasing governmental subsidies or more likely, the collapse of Ariana.

The Possibilities Open to Afghanistan

It is necessary therefore to consider the sort of conditions which Afghanistan might seek to obtain in its bilaterals and the sort of policy it should adopt in its negotiations with a view to minimising (or ending) its requirements for government money.

The sort of things that might be considered include the following:

- Agreements to regulate capacity to avoid over-supply. This would be intended to keep fares at a remunerative rate and prevent Afghan services from being swamped.
- Agreements to schedule services to avoid bunching. This would mean some sort of pooling agreement to compensate for services run out of the peak.
- Agreements on fares and interlining. This would be linked to (ii) above and enable passengers to use a ticket on either airline.
- Agreements to code share. This would, for example, allow Ariana to take seats on the other airline and retail them itself, at a profit. It is sometimes the case that each airline has its own cabin crew on board; sometimes that one airline acts for both. This would enable Ariana to derive revenues at minimal cost (and at no capital cost).
- Agreements to handle each other's passengers. This is a normal commercial arrangement. But as competition intensifies airlines tend to want to build-up their brand by handling their own passengers. This would be expensive for a small airline like Ariana and the bilateral negotiations could be used to obviate the risk.
- Agreements, for example for long-haul routes, that Ariana would feed its passengers to longer-haul routes operated by the reciprocal airline (e.g. westwards from the Gulf, eastwards from Pakistan, India, Malaysia or Singapore) in return for a share of the revenue derived. This again would provide revenues without capital expenditure.

Most important of all is the choice of routes. Ariana should give priority to those routes which would bring it the most revenues most rapidly. This assessment is a mixture of political feasibility and commercial assessment. At the moment Ariana is - for understandable reasons - operating with aircraft which were not necessarily those they would have chosen to run the routes they wanted to run. If Ariana is to succeed, it is essential to reach a situation in which it can have at its disposal the aircraft most suitable for the routes it regards as to its advantage to run.

Whether its commercial policy accords, for example, with the sort of arrangements suggested in para 5 above is a matter for its own and the government's assessment of the possibilities.

To do this job properly, TSR considers that it would help if the MCAT were strengthened temporarily by the addition of expertise from abroad. TSR therefore recommends that two people be made available to MCAT with the following expertise:

- One to study the route structure of the airline and propose modifications in the light of actual and forecast traffic, - assess the commercial suitability of the aircraft used on the various routes and propose options, - consider the possibility and benefit of entering into commercial cooperative agreements with other airlines, - enhance the management capabilities and efficiency of the airline's commercial department and its personnel, - provide on the job training, and help in the implementation of aviation policy and in the conduct of bilateral negotiations.
- One to assist in the implementation of the policy proposed by TSR in the conduct of bilateral negotiations. His / her function would be to work with Ariana to review the existing and future route structure and as necessary propose new bilaterals in the light of the objectives proposed by TSR and to assess the commercial and political feasibility of the various options; generally to advise MCAT on all aspects related to air transport, and to provide on the job training.

The experts should operate as a team and should work closely with the MCAT Capacity Building Unit. The negotiation of bilaterals is very much a joint operation between government and airline; and it is common that inter-governmental negotiations on the formal text go on simultaneously with inter-airline negotiations on the commercial arrangements which would underpin the text and which would, normally, be the subject of annexes or memoranda of understanding accompanying the governmental text. Their period of appointment should be coordinated; TSR suggests an initial period of one year, though it may well turn out that two year appointments are necessary.

The cost would depend to some extent on where the experts came from. TSR suggests a budget of between USD 400,000 and 600,000.

Recommendations

Afghanistan should use the opportunities afforded by the system of bilateral agreements which underlies the international aviation system to protect and support Ariana until it is firmly established.

Actions:

Two experts should be recruited to support MCAT in the negotiations of bilaterals for one or possibly two years. MCAT should approach a donor for funding.