

## MARITIME AND AIR TRANSPORT SERVICES: INDIA'S APPROACH TO PRIVATIZATION

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### ABSTRACT

*As part of a broader reform programme, the Government of India embarked upon a privatization programme in the 1990s to improve the performance of the transport sector and speed up the investment process in the transport sector. This paper provides an overview of government policies and initiatives that have been taken to promote private participation in the maritime and air transport subsectors and an assessment of the progress made so far.*

*There has been some success in attracting private sector involvement in these two subsectors. This paper has identified some issues and concerns and makes some suggestions that would further increase the level of private participation. The paper draws some conclusions in the light of experience gained from the privatization initiatives in the maritime and air transport subsectors.*

### INTRODUCTION

The linkages between international trade and the transport network are obvious. An efficient transport system can boost trade and greater volume of trade can, in turn, create demand for investment in the transport network. It is now widely acknowledged that efficiency in the transport sector has major spillover effects on the competitiveness of both goods and services. Competition and increased efficiency in maritime transport services, resulting in lower freight rates, contribute

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directly to a country's international competitiveness. Similarly, the development of air transport services is crucial for the sustainable development of trade and tourism. This sector acts as an economic catalyst by opening up new market opportunities, moving products and services with speed and efficiency. The quality of the transport network has direct implications for the inflow of foreign direct investment (FDI).

In the past, the requirement of large-scale investment, long gestation periods, uncertain returns, associated externalities together with social objectives such as consumer protection, welfare and equity have resulted in government monopoly in transport services. In many developing countries, the Government owned, operated and financed the transport sector and success and failure in the provision of such services was largely a story of government's performance. This picture is rapidly changing with globalization and the liberalization of national economies. Increased commercialization and growth of international trade has led to considerable pressure on the operating environment of the existing transport infrastructure, forcing it to adapt new, improved and more reliable technology. Commercialization has also enhanced competition among trading nations to increase their share in the world's trade. For instance, with increasing size and sophistication of ships, container ships now make only a few calls in three or four harbours at each end of the trade while the rest of the traffic is served by small feeder ships. This has increased the competition among neighbouring harbours to develop as "hub" ports catering to large container ships. Governments all over the world are finding it increasingly difficult to finance the investment required to sustain the growth of transport infrastructure. On the other hand, globalization has given birth to large multinational corporations and alliances that have the willingness, financial strength and technical know-how to operate and manage the advanced transport network. This has created a unique situation whereby countries, which were once closed-door, are opening-up their corridors for privatization and foreign investment.

The Indian aviation and maritime transport sectors have not been an exception to this trend. Prior to the 1990s, the Government was the main provider of these services and there were various restrictions on private participation. During that period, the performance of these sectors was marked by monopoly-induced inefficiency and low

productivity. In fact, in both of these transport services, India's share in world trade had been steadily declining. In the 1990s, when India embarked upon an ambitious reform programme, the demand-supply gap in transport infrastructure became more pronounced. The need of the hour was to rectify the infrastructural bottlenecks to sustain the reform programme. It is at this juncture that the Government announced various reform measures in air and maritime transport services, including privatization. It was expected that privatization would increase efficiency through competition, reduce the financial constraints and speed up the process of adaptation of new technologies.

The following section will provide a broad overview of maritime and air transport services in India. It will critically analyse the policies and developments in these sectors since the 1990s. The subsequent section will suggest various regulatory, fiscal and other reforms which could facilitate the privatization process and improve the overall efficiency, productivity and global competitiveness of the sectors.

## **I. AN OVERVIEW**

### **A. Maritime transport**

Maritime transport is by far the main mode of international transport and over 90 per cent of India's trade volume (77 per cent in terms of value) is moved by sea. The Indian peninsula, situated in the Indian Ocean, is also strategically located between the Atlantic Ocean in the west and the Pacific Ocean in the east, with a 5,560 km long coastline, and 12 major<sup>1</sup> and 148 operable minor and intermediate ports. India now has the largest merchant shipping fleet among the developing countries and ranks seventeenth in the world in shipping tonnage. Indian maritime services sector not only facilitates the transport of national and international cargoes but also provides a variety of other services such as cargo handling services, ship repairing, freight forwarding, lighthouse facilities and training of maritime personnel.

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<sup>1</sup> The 12 major ports are: Calcutta (including Haldia), Paradip, Vishakapatnam, Chennai, Ennore and Tuticorin on the east coast and Cochin, New Mangalore, Mormugao, Jawaharlal Nehru, Mumbai and Kandla on the west coast.

The maritime transport system falls under the purview of the Ministry of Shipping. The shipping industry is governed by the Merchant Shipping Act, 1958, and the Director General of Shipping is the regulatory authority for all activities related to shipping. The salient features of India's shipping policy are the promotion of national shipping to increase self-reliance in the carriage of country's overseas trade and protection of the interest of shippers. India's national flagships provide an essential means of transport for the import of crude oil, petroleum products, coal and fertilizer, export of iron ore, and exports and imports of various general (liner) cargoes. National shipping also provides for a second line of defence in times of war and emergency and contributes significantly to the foreign exchange earnings.

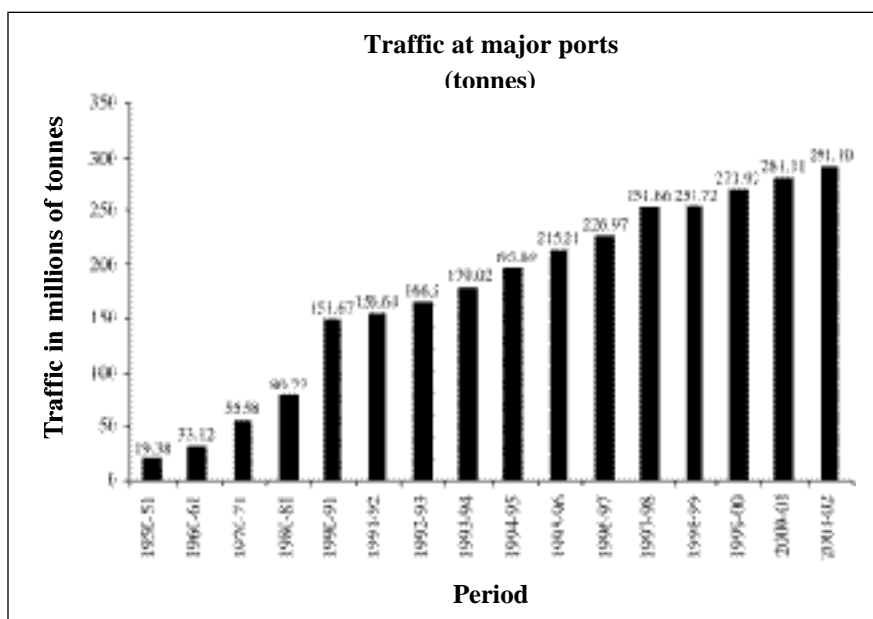
Even before the 1990s, the shipping industry was fairly liberalized and there were no major restrictions on the entry of private shipping companies. Indian shipping, as it exists today, is marked by the presence of a few large and medium sized national shipping companies and a host of private players that together carry around 30 per cent of the country's overseas trade. On the eve of independence in 1947, India had only 60 vessels with a tonnage of 0.192 million gross registered tonnage (grt). By December 2001, these figures increased to 555 vessels and 6.91 million grt respectively.<sup>2</sup> Nevertheless, this growth lagged far behind the proposed growth target of 9 million grt for the Ninth Five-Year Plan (1997–2002) and the national flag carriers are fast losing their share of trade to major global players.

From time to time, the Government has announced various measures to support the growth of the domestic shipping industry. Government-owned/controlled cargo is channelled by the chartering wing of the Ministry of Shipping, "Transchart". As per this policy, the first right of refusal for carriage of such cargoes is given to Indian vessels. More recently, in the Union budget 2002-03, the Government offered various fiscal incentives for the modernization and expansion of fleets. These include exemption of shipping companies from the minimum alternative tax if they transfer an amount that is twice the aggregate of the paid up capital, general reserve and share premium reserve to a special account meant for ship acquisition.

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<sup>2</sup> Ministry of Shipping, Annual Report, 2001-02.

Unlike shipping, prior to the liberalization, the port sector had largely been a public monopoly. Major ports are under the Ministry of Shipping and are governed by the Major Port Trusts Act, 1963. Intermediate/minor ports are administratively under the respective state governments and are governed by the Indian Ports Act, 1908. Major ports cater to the bulk of traffic (around 75 per cent in 2001). The traffic through major ports increased from around 19.4 million tonnes in 1950-51 to 291.1 million tonnes in 2001-02. This growth has not been uniform. Figure 1 shows that in the first 30 years (1950-51 to 1980-81) the increase in traffic was only 60 million tonnes. After the liberalization in the 1990s, there was a sudden spurt in traffic, which grew by 130 million tonnes in the 10-year period, 1990-91 to 2000-01.



Source: Ministry of Shipping, Government of India.

**Figure 1. Traffic at major ports**

**Increase of traffic between:**

1950-51 and 1980-81 (30 years) [5 ports]	– 60 million tonnes
1980-81 and 1990-91 (10 years) [10 ports]	– 71 million tonnes
1990-91 and 2000-01 (10 years) [11 ports]	– 130 million tonnes

The sudden increase in traffic in the post-liberalization period brought to light the capacity constraints, inefficiencies and low productivity of the Indian ports. In addition to privatization, various steps were taken by the central and state governments to improve port performance. Some of these steps include:

(a) The power of the Port Trust Boards to sanction projects was increased to Rs. 500 million in the case of additional/new investments and to Rs. 1 billion in the case of replacement/renewal of assets;

(b) An independent Tariff Authority of Major Ports (TAMP) was set up for fixing and revising the port tariff;

(c) The Major Port Trust Act was amended to enable major ports to enter into joint ventures with minor ports;

(d) A Maritime State Development Council was constituted under the Chairmanship of the Union Minister of Shipping to have an integrated approach to development of major and minor ports;

(e) The major ports were also allowed to enter into joint ventures with foreign ports and foreign companies;

(f) An Empowered Committee on Environmental Clearance (ECEC) was constituted in the Ministry of Shipping to provide simplified and transparent guidelines for environmental clearance.

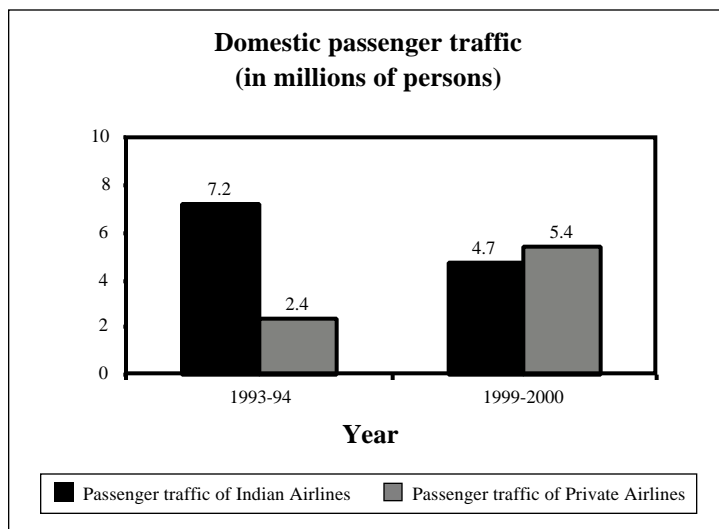
## **B. Air transport services**

The Indian air transport services were initially developed under private initiatives. However, in 1953, under the Air Corporation Act, the operation of scheduled air services was made a public monopoly. This monopoly lasted for almost 40 years until it was repealed by the Air Corporations (Transfer of Undertaking and Repeal) Act, 1994. At present, the air transport sector is fairly liberalized with Air India and Indian Airlines – both public sector undertakings – providing international air services together with a host of foreign carriers. Apart from Indian Airlines some private airlines, such as Jet Airways and Sahara, operate domestic air services. Infrastructure facilities at airport terminals are provided by the Airport Authority of India (AAI),

a statutory body under the Ministry of Civil Aviation. The Ministry of Civil Aviation formulates national policies and programmes for the growth, development and regulation of civil aviation. The Directorate General of Civil Aviation (DGCA) is the principal body under the Ministry for the regulation of air transport to/from/within India in accordance with the provisions of the Aircraft Rules, 1937, bilateral and multilateral agreements with foreign countries and the policy pronouncement of the Government. Security related issues are handled by the Bureau of Civil Aviation Security.

Although air cargo accounts for less than 5 per cent of the total volume of cargo exported, air transport services play a crucial role in the transport of high-value items and capital goods. Growth of the tourism industry is directly related to the performance of the aviation industry since more than 92 per cent of foreign tourists arrive by air. The country has around 449 airports/airstrips, of which only 61 are in an operational state. There are 12 international airports but the top 5 of them (Delhi, Bangalore, Mumbai, Chennai and Kolkata) together handle over 70 per cent of total passenger traffic and 85 per cent of cargo traffic. These figures suggest an uneven flow of traffic resulting in a lack of infrastructure at certain places and, at the same time, a massive underutilization of the existing network of airport infrastructure.

In 2001, Air India and Indian Airlines had fleet sizes of 27 and 50 aircraft, respectively. The operating performance of both these airlines is below international standards and they have been showing net operational losses for successive years. In fact, Air India had to pull out of many lucrative routes and currently the Middle East is the only major destination. On the domestic front, with the advent of private players Indian Airlines is fast losing its market share to private airlines (see figure 2) and in 2002 its share of domestic traffic was around 40 per cent. On the whole, the Indian civil aviation sector is marked by lack of funds for modernization and expansion, low productivity, underutilization of resources, low fleet base, overmanning, a limited international network and unremunerative yields.



Source: *Air Transport Statistics*, various issues, Ministry of Civil Aviation.

**Figure 2. Domestic passenger traffic**

## **II. DEVELOPMENTS IN THE 1990s**

### **A. Maritime transport services**

#### **1. Shipping**

Liberalization and reforms of the 1990s made the environment of shipping more competitive – both in terms of cargo and resource mobilization markets. In such an environment, only those industries that have developed a competitive advantage can thrive. Indian domestic lines, both private and public, which were so far protected by government cargo reservation policies and had outdated fleets, found it extremely difficult to face international competition. As a consequence, although the volume of overseas trade more than doubled in the 1990s, the share of domestic lines steadily declined. Major policy changes which affected the shipping industry were the relaxation of the cabotage law and cargo reservation policy, whereby foreign flag ships were allowed to operate on a case-by-case basis. Foreign ships calling at Indian ports no longer required a license for overseas trade.



The Government did not remain a mere spectator. To enable the domestic industry to mobilize resources and facilitate the acquisition of funds, the Government made several amendments to the Merchant Shipping Act and simplified the regulatory procedures for raising resources in order to facilitate the acquisition of new/second hand vessels at competitive prices. The Government also granted automatic approval for foreign direct investment up to a limit of 74 per cent and non-resident Indians (NRIs) were permitted to invest up to 100 per cent with full repatriation benefits.

In the past, Indian ships had to be repaired at Indian yards, which were not competitive either in terms of costs or time. This restriction was removed and shipping companies – both private and public – can now get their ships repaired in any shipyard without seeking prior approval of the Government.

However, these measures did little to boost the morale of the shipping industry and revive the recessionary trends. Shipping is a capital-intensive industry and in spite of the above-mentioned reforms, both the private and public players have not been successful in mobilizing the requisite funds and run a profitable operation. The shipping industry has blamed the Government for this. Industry representatives have repeatedly pointed out that unlike many developed countries, the Indian industry is not subsidized, nor does it have the status of an infrastructure industry or export industry which would enable it to enjoy the tax benefits applicable to such industries. The Indian shipping industry is facing a much higher tax regime than its international competitors. The industry has to pay a corporate tax based on profits whereas India's major trading partners have implemented a tonnage tax regime.

On the whole, the domestic shipping industry – where the public and private sectors had coexisted under a protective umbrella prior to the liberalization – did not gain much in the post-liberalization period. Shippers, on the other hand, were the main beneficiaries. They had access to better quality services at lower/competitive rates.

More recently, the Government is considering the disinvestment of Shipping Corporation of India (SCI), a public sector undertaking,

which owns 45 per cent of the country's fleet. The Government, which owns a 80.12 per cent stake in SCI, initially planned to offer 40 per cent of its stake to oil public sector units (PSUs) and refineries. But since the oil companies did not show any interest, the Government has now decided to sell 51 per cent of its stake in SCI through an open offer. Out of this 51 per cent, a foreign investor can pick up a maximum of 25 per cent. The Government also proposes to sell 3 per cent of the equity to employees of SCI, bringing its stake down to 26 per cent. Three disinvestment routes have been offered to interested bidders – the bidders can either form a consortium, or a special purpose vehicle (SPV) or have a group affiliate company pick up the stake. Since the disinvestment process has yet to be concluded, it is too early to discuss the Government's disinvestment policy. Nevertheless, some of the bidders have raised certain concerns. The bidders fear that since the Government will continue to have a 26 per cent stake after disinvestment, the new owner may find it difficult to restructure the company on issues such as tonnage stripping and reduction in the workforce. There are also unresolved issues concerning SCI's stake in its two joint ventures – Irano Hind Shipping Company Limited and Greenfield Holding Company (for LNG<sup>3</sup> transport). With Greenfield already in a cash crunch, bidders want SCI to exit its two joint ventures before disinvestment. Although the Government has stated that SCI would continue to partner both ventures, it remains to be seen whether there is a change in decision to clinch a better deal.

## **2. Port facilities**

With the opening-up of the economy, resulting in a growing volume of international trade, it became necessary to upgrade and modernize the port infrastructure. To encourage private participation in port projects, the Government issued a comprehensive guideline for private participation in major ports in 1996. The following areas have been identified for private sector participation:

- (a) Leasing out the existing assets of the ports;

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<sup>3</sup> LNG is liquefied natural gas.

(b) Construction and operation of container terminals, multi-purpose cargo berths, and specialized cargo berths, warehousing and storage facilities, tank farms, container freight stations and setting up captive power plants, etc.;

(c) Leasing of equipment for cargo handling and leasing of floating rafts from the private sector;

(d) Pilotage;

(e) Captive facilities for port based industries.

The policy recommended that private participation in port projects should be through a competitive bidding and on a build-operate-transfer (BOT) basis. The policy also stated that the concerned Port Trust would not give any guarantee for financial returns or expected tariff to the private sector. In parallel, the port sector was opened to foreign investment. Foreign equity participation was allowed up to 74 per cent through an automatic route in construction activities in ports and harbours and up to 51 per cent in support services such as the operation and maintenance of piers.

Unexpectedly, this policy received a lukewarm response. In the next few years, the Government juggled with a series of policies and amendments to the existing ports and shipping acts. The next major policy initiative was the setting up of TAMP – the independent tariff regulatory of major ports. To lure foreign investment, the Government further liberalized the foreign investment policy, allowing 100 per cent FDI in construction of ports and harbours through the automatic route. Foreign investors were also allowed to enter into joint ventures to develop port facilities. The Ninth Five-Year Plan, which began in 1997, placed emphasis on private participation in both major and minor/intermediate ports. Additionally, a series of fiscal incentives were extended to lenders and developers of port projects. For instance, a 10-year tax holiday was announced for the development of ports. This can be used in the first 20 years of operation. Import duties on equipment have been significantly reduced. The Government also granted a tax concession of 40 per cent to financial institutions on income from financing port projects and earnings from funds invested in infrastructure projects are also exempted from income tax.

Subscription to equity shares and debentures issued by infrastructure companies are now eligible for a 20 per cent income tax deduction up to a limit of Rs. 70,000 a year.

The Government's effort to attract private investment has not all been in vain. Many new port development projects have been sanctioned in the 1990s. A new major port, Ennore, near Madras was sanctioned in April 1993. This project was financed by the Asian Development Bank, which sanctioned US\$ 150.15 million for the project. The Chennai Port Trust has developed the Ennore Port under a "landlord" concept, i.e., the common infrastructure is developed by the port, while the berths and equipment therein are financed by private developers on a BOT basis. The Ennore port started functioning from January 2001. In 1997, P&O Ports Australia was awarded the contract for setting up a new container terminal in Jawaharlal Nehru Port Trust (JNPT). In recent years, the same investor has won the twin contract to develop container terminals at Chennai and Kochi on a BOT basis. In 1998, another global player, the Port of Singapore Authority, was given the contract for developing and maintaining the container handling facilities at Tuticorin. The domestic investors are not far behind. Gammon India has tied up with Protia Management Services of the United Kingdom of Great Britain and Northern Ireland to form Vizag Sea Ports Limited, which will construct two new multi-purpose berths at the port.

In addition to the steps taken by the central government, governments of the coastal states have also taken initiatives to develop the minor ports within their jurisdiction. All maritime states have issued policy statements, which highlight the various incentives offered by the respective state governments for investment in port projects. Various development projects through private participation have been sanctioned in the States of Gujarat, Maharashtra and Andhra Pradesh. The Pipavav and Mundra ports in Gujarat have been developed as joint ventures between the Gujarat Maritime Board (which has a 26 per cent share), private sector (25 per cent) and the public (49 per cent). P&O Ports Australia has been awarded the contract for operating container terminals in Vadhawan (Maharashtra).

An analysis of private sector participation in port projects reveals a clear trend – private investors are more interested in the operation of

container terminals and in the development of minor/intermediate ports. This is mainly owing to the fact that most private and foreign investors prefer to invest in projects with short gestation periods and strong revenue streams.

It is often argued that in comparison to other Asian countries such as China, India has been far less successful in its privatization drive and the whole process has been slow and hesitant. For instance, it has taken three years to finalize procedures and invite tenders for privatization of JNPT container terminal. Case studies of some of the BOT port projects in India<sup>4</sup> show that private investors have not responded as affirmatively as expected owing to the tendency of the Port Trusts to demand an unreasonable share of anticipated earnings, especially during the early stages of operations. Port projects have long gestation periods and require substantial investments. The revenue realization is delayed until the completion of the projects and may not be adequate to cover all costs, particularly in the initial years of operation. There are several flaws in the BOT concession agreements. The main drawback is that the investor's investment is not backed by a legal statute, although it is a common practice in South-East Asian countries and the United States of America. Furthermore, the agreement does not take into account the geo-technical and socio-commercial features of the individual ports so that there could be some concessionary adjustments and preferential incentives for development of ports in backward areas. The agreements also state that assets financed on a BOT basis will revert free of cost to the Port Authority at the end of the concession period. This is a possible deterrent to continuous upgrading and modernization of facilities during the term of the concession.

Private investors in major ports do not have the autonomy to fix their own tariff subject to market conditions, since tariffs in these ports are regulated by TAMP. This acts as a constraint on the operational efficiency of the projects. Foreign investment in cargo related projects is scarce since TAMP does not allow cost recovery through forex-linked tariffs.<sup>5</sup> Also, private investors at major ports cannot implement their

<sup>4</sup> Bennett and Eswaran (1996).

<sup>5</sup> However, container handling charges can be levied in foreign currency and are treated as vessel-related charges, resulting in the keen interest shown by foreign companies in containerization projects in the country.

own employment policies as the labour hired by the privatized firms in privatized berths are subject to labour laws as defined by the Ministry of Labour. The complexity of rules, lack of a clearly defined action plan and the long and unpredictable approval process have often made the projects commercially non-viable.

A major constraint in the process of privatization of minor ports has been the lack of adequate infrastructure facilities linking the ports and the hinterland. In many minor ports, the investors themselves have taken initiatives to set up the rail and road connectivity. For instance, in January 2000 Pipavav Port formed a joint venture with Indian Railways to set up a rail connection to the main network.

Despite the various fiscal incentives offered by the Government, the financing of port projects is still clouded with a lot of doubts. The debt-equity ratio of 60:40 for financing port projects is more conservative than that of other sectors. This is because there is no traffic guarantee. As a result, banks and financial institutions are somewhat wary to finance this sector.

If one looks at the impact of liberalization and privatization on port productivity there is no doubt that the productivity of Indian ports has increased manyfold since liberalization. The average ship turn around (ASTA) time has declined from 11.9 days in 1984-85 to 4.17 days in 1999-2000 and the average ship berth output improved from 2,314 tonnes per day to about 6,321 tonnes per day during the same period. However, this improvement in performance does not compare favourably with that of other efficient ports in the region. For instance, the ASTA time at the ports of Singapore, Hong Kong, China, and Colombo is only a few hours. The total container cargo handled by all ports in India is much lower than that handled at a single port of Singapore or Hong Kong, China. Hence, much needs to be done in terms of improvement in efficiency and productivity. The proposed Tenth Five-Year Plan (2002-2007) gives high priority to modernization and the development of port infrastructure through private investment. The Government would largely act as a facilitator, removing the existing restrictions and enabling private players to make profitable investments. The Union budget (2002-03) has worked towards this end. On the one hand, there is a 66 per cent drop in public funding for the port sector,

on the other, the budget proposes a reduction in custom duty on equipment used by port and port services. This will enable a reduction in the capital cost for port developer and service providers. The Government has also implemented various schemes to enable the development of special economic zones around the ports, which can also make port investments more attractive.

## **B. Air transport services**

### **1. Airlines**

Prior to the 1990s, it was felt that monopoly in the aviation sector was necessary to reap the benefits of economies of scale, ensure safety and security and enable the country to achieve social objectives of equity, welfare and consumer protection. During that period, the Government had a monopoly in the building of airports, from conception to delivery, with business assured for national carriers that were also monopoly users.

With liberalization and the increase in international travel, the need to enhance the quality of service and improve capacity became obvious. It became increasingly difficult for the government to finance the development of airport facilities and increase airline capacity, hence, there was a move towards privatization and foreign investment.

The scope for privatization in the Indian aviation industry is limited to the construction, operation and maintenance of airports and operation of air services. Since air traffic control is considered to be closer to a public good and regulatory in nature, India, like most other countries, has not opened up this sector for privatization. There is very limited scope for development of the aircraft manufacturing industry, except for the manufacturing of certain low-end aircraft.

The first step towards liberalization was as early as 1986 when private airlines were allowed to operate charter and non-scheduled services<sup>6</sup> to all authorized airports under the Air Taxi Scheme and to decide their fares and flight schedules. This Scheme was implemented to boost the tourism industry.

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<sup>6</sup> That is, they could not publish time schedules or issue tickets to public.

A major move towards liberalization was in the early 1990s when India implemented an open sky policy<sup>7</sup> for cargo which allowed international airlines to operate cargo flights without restrictions and to charge rate without reference to DGCA. Under this policy, any foreign or domestic airline or association of exporters or private operators can bring freighters to the country for lifting cargo from any Custom airport. The purpose of this policy was to facilitate the growth of international trade, exports in particular. Following this, several private international airlines began to operate air cargo flights. The immediate effects of this policy were an improvement in the availability of timely cargo services at competitive rates, decline in cargo rates and increase in volumes handled by as much as 15-20 per cent per year. However, there still remain restrictions on cabotage – international airlines are not allowed to carry domestic cargo on their flights within the country.

The next major step was the termination of the state monopoly over scheduled air transport services with the enactment of the Air Corporation (Transfer of Undertaking and Repeal) Act, 1994. The main reasons for the deregulation was the decline in profitability of Air India and Indian Airlines owing to organizational and managerial inefficiencies and that the capacity of the national carriers was not enough to meet growing passenger demand. With the enactment of the 1994 Act, private operators were allowed to operate both scheduled and non-scheduled services in the domestic sector and there were no major restrictions on aircraft size and type. However, in order to ensure safety, security and orderly growth of air transport services and keeping in view the infrastructural constraints at a number of airports, the Government permitted the addition to capacity based on traffic projections. To support the growth of the airline industry the Government in 1994-95 permitted direct import of aviation turbine fuel (ATF) under the special import license scheme. In 1997-98, the privatization policy was further liberalized and foreign equity participation of up to 40 per cent (100 per cent in case of non-resident Indians) was allowed in the domestic airline sector. Foreign airlines are, however, not allowed to pick up the equity, directly or indirectly.

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<sup>7</sup> An open sky policy, even in other countries, does not imply that the market is entirely competitive. Landing rights are constrained by the notion of bilaterals, which is a major factor restricting competition from a third country's carrier.



The private sector initially responded with lot of enthusiasm and euphoria. In fact, by April 1998 there were 7 scheduled private operators which operated alongside of Indian Airlines and 27 non-scheduled operators. Subsequently, many of them had to wind up their operations and only two private airlines – Jet Airways and Sahara are now operating in India. The Government cannot be blamed entirely for this failure. A large part of the failure was owing to internal reasons such as lack of adequate financial resources, lack of knowledge about the business, frequent shifting of routes and operation and management inefficiencies.

An important reason for the failure of private airlines is the high price of ATF. The price of ATF in India is almost 2.5 times higher than the world price. Many state governments have imposed sales tax on ATF, ranging from 20-35 per cent. This itself has imposed an additional burden of 10 billion rupees on the aviation industry and has severely affected the profitability of operators.

Another policy which has adversely affected the operation of private airlines is the categorization of air routes. The Indian Civil Aviation policy has classified the air routes in three categories, as mentioned below, taking into account the need for air transport services in different regions.

*Category I:* Consists of routes to and from:

- Mumbai to Bangalore, Calcutta, Delhi, Hyderabad, Chennai and Trivandrum;
- Calcutta to Chennai and Bangalore;
- Delhi to Bangalore, Hyderabad and Chennai.

*Category II:* Connect stations in the north-eastern regions, Jammu and Kashmir, Andaman Nicobar Islands, and Lakshwadeep.

*Category III:* Consists of routes other than those in category I and II.

The policy states that 50 per cent of the kilometrage done by an airline on the category I routes has to be compulsorily done on the category III routes and 10 per cent on the category II routes. Since

most private operators have large aircraft which are suitable for category I routes only, it became economically unviable to operate them in category II and III routes. It has been estimated that this has imposed a burden of around 800 million rupees for the north-eastern sector alone. Many private operators lacked the scale required to maintain separate aircraft for flying to different routes. Most countries globally meet the social objective of route dispersal through direct cash subsidization whereas in India the industry is expected to bear the burden through cross-subsidization.

Private domestic operators are not allowed to operate on international routes even in cases where no national carrier is flying to certain countries such as Spain and Australia. Other factors resulting in the failure of private participation are the lack of transparent and consistent government policy, high rates of airport charges, high inland air travel tax, lack of adequate airport infrastructure and limited watch hour problem at minor airports.

In the year 2000, the Government announced the disinvestment of Indian Airlines. It has been proposed that 51 per cent of the equity of Indian Airlines will be disinvested, out of which 26 per cent will be given to a group/company/individual that has been referred to as a strategic partner. The remaining 25 per cent will be offered to employees, financial institutions and the public. In line with domestic air transport policy, foreign airlines will not be permitted to pick up the stake. The Government also proposed the disinvestment of 60 per cent of its stake in Air India, of which 40 per cent equity will be given to a strategic partner (which includes 26 per cent of the total equity to a foreign airline), 10 per cent to employees and the balance will be offered to employees, financial institutions and the public.

Although the Government has been considering the disinvestment of national carriers for quite some time, so far nothing has emerged. This is primarily because of shifts in government policies and slow decision-making. In the initial stages, many foreign airlines such as Singapore Airlines, and domestic companies such as Tata, showed their interests in this sector – but this has slowly died down owing to delays in decision-making. In the current year, the Government has further

deferred the disinvestment process in the anticipation that the airlines will fetch a better price once the global economy recovers.

## **2. Airport facilities**

In 1997, the Ministry of Civil Aviation brought out a policy on airport infrastructure. This policy emphasized the need for private investment to increase airport capacity and achieve a higher level of customer satisfaction. In order to facilitate private participation, the policy proposed the establishment of an airport restructuring committee in the Ministry of Civil Aviation. This committee would identify the airports where private participation is required and conduct the feasibility study for the benefit of the private players. An independent statutory body, the Airport Approval Commission, would examine the private sector proposals and submit them to the Government. The policy also laid down various fiscal incentives for airport development.

In the initial stage, the Government encouraged private participation in the construction of new airports on a BOT basis similar to that envisioned for seaports. Foreign airport authorities were also allowed to invest in such projects and foreign equity participation was allowed up to 74 per cent (100 per cent with special permission). Some private sector aided projects have already been completed. For instance, the Cochin airport was commissioned on a BOT basis. Projects for development of new airports with private participation are also coming up at Bangalore, Hyderabad, Mumbai and Goa.

In the Union budget 2002-03, the Government announced its decision to upgrade the international airports at Delhi, Mumbai, Chennai and Kolkata by inducting private sector management and investment through long-term leases. This lease process is expected to be completed in the current financial year.

Overall, the government's airport privatization policy is marked by indecisiveness, inconsistency and lack of transparency. Previously, the Government considered the corporatization of the Airport Authority of India and privatization on a BOT basis, but is now moving towards long-term leases.

### **C. Some general observations on various government initiatives**

To sum up, although the policy initiatives in the maritime and air transport sector do reflect the Government's acceptance of the need for privatization and foreign investment, they fall short in many respects and there are loopholes in major policies. They are characterized by lack of clarity and openness, discretion, overt and covert forms of discriminatory treatment towards some categories of investors and lack of strategic planning. For example, although the civil aviation policy states that private participation will increase investment and enable the sector to improve the quality of services, efficiency and global competitiveness, the policy does not clearly spell out the terms and conditions and the means by which such encouragement will be provided to the private investors. The port development policy lacks foresight and planning. While most other developing countries (for example, Sri Lanka) have used private/foreign investments to develop one or two ports as hub port/s, in India the investment is scattered across several major and minor ports. As a consequence, none of the ports have emerged as a hub port and India is losing valuable foreign exchange in transshipment to other Asian ports, such as Singapore and Colombo.

In the air transport sector, although the Government has proposed the disinvestment of Indian Airlines, a foreign airline is not allowed to pick up the stake. Who, other than a foreign airline, would otherwise be interested to invest in a loss-making domestic airline? How can an airline benefit from liberalization if it cannot leverage the network resources or benefit from the technical and managerial expertise of a foreign airline?

Similarly, in the case of ports, without any power to reduce manning scales, how can a private player operate profitably? Hence, it is not surprising that there has been limited progress towards privatization in these sectors.

### **III. WHAT NEEDS TO BE DONE?**

#### **A. Maritime transport**

Private sector participation in maritime and air transport services would depend on the ability of the Government to foster and nurture an investment-friendly climate. The latter has not happened. There is urgent need to rectify the existing loopholes in the policies and implement an appropriate regulatory structure to ensure transparency, fairness and a level playing field without jeopardizing consumer and national interests. For instance, in the case of ports, the license agreement should address clearly the various risks involved in the pre-construction, construction and operational phases. In civil aviation, various issues, such as future traffic allocations, terms of transfer of ownership of titles to make land available and strengthening of related infrastructure need to be solved before the privatization of airports takes place. The civil aviation policy, which has been under consideration for over five years, needs to be finalized and released with immediate effect since the lack of a transparent document discourages private investment because of the increased risk perception owing to likely changes in policies.

In both these transport sectors, the Government should act as a facilitator and do away with its control over operation and management. Ports and airports should be corporatized, giving the management more freedom in decision-making and making them accountable for their performance. There is need for a strong, independent, transparent and reliable regulatory authority, which would balance the interests of the public and the private sector, domestic and foreign businesses, buyers and sellers.

There is urgent need to develop the intermodal transport system and allied logistic services, such as warehouses and container freight stations. Unlike most countries of the world, many major ports in India do not have rail connectivity. The slow pace of development of the inland transport chain has delayed the process of private investment. Gujarat is one classic example which has tremendous potential for private investment in ports but lacks the basic infrastructure. A study should be undertaken to consider how the ports and the supply chain as

a whole could benefit through efficiency gains from improved logistics facilities and rail connectivity of ports with the hinterland.

Tax structures should be revised to enable the industry to achieve a competitive edge. In shipping, the existing corporate tax should be replaced by a tonnage tax, which would, in turn, strengthen the domestic shipping industry. In aviation, a reduction in tax on ATF and duties on domestic air travel would enable the industry to become more competitive.

In order to ship Indian container cargoes directly through Indian ports, the ports will require large container terminals with adequate quay cranes, gantry cranes, tractor-trailer systems, trained and efficient operators, paved areas, good rail/road link, container trains, ICD facilities, automation and well-knitted cooperation of various agencies involved in the exercise. Such developments require massive investments and substantial planning, hence, it may not be possible to develop all the ports simultaneously. Ideally, India needs to develop two major ports initially: one on the east coast (for example, Chennai) and another on the west coast (for example, JNPT), into transshipment hubs so that most Indian cargoes can be shipped from and received at these ports. The hub port in the west coast will cater to westbound cargo covering the Atlantic region and that in the east coast will cover the Pacific region. These two hubs can then be interlinked through a “land bridge” and this will make the whole operation cost effective and reduce delays (since the shipping lines can avoid going round the Indian peninsula). However, a study will be required to examine this suggestion further and to work out the details of hub-port operations and of connecting them by a land bridge.

Privatization of Indian ports has been slow and hesitant. One of the main reasons for this is that India does not have any sectoral master plan outlining the short, medium and long-term development opportunities in the port sector. While the Ministry of Shipping is responsible for projects being taken up by the major ports, the respective state governments and their agencies are responsible for minor port projects. The projects for development of the minor ports can be vulnerable to significant traffic risks since these ports are in close proximity to each other and also to some major ports. This has slowed

down private investment in projects initiated by the eight coastal states. Moreover, there is no common development strategy and different states have implemented their own policies. For example, in some ports of Gujarat and Maharashtra, the state governments have equity participation while in other states such as Kerala, the Government provides the basic facilities such as break waters, capital dredging, navigational aids and communication equipment. The absence of a common BOT policy creates confusion among private players investing in this sector. Moreover, most Indian ports compete with each other for private investment rather than with other Asian ports.

To facilitate speedier investment in the port sector and to catalyse investment intentions into actual investment, there should be a sectoral master plan outlining the short, medium and long-term development opportunities in the port sector based on national economic trends and a tentative forecast of traffic patterns. The master plan should ensure that the projects undertaken by the central and state governments do not compete with each other, leading to subsequent non-viability.

The role of TAMP needs to be carefully scrutinized. Private operators should be given the flexibility to charge tariffs as determined by market forces. Even if there is a regulator, tariff regulation should be based on ceiling rates, leaving to the operators the freedom to apply or negotiate tariffs below the maximum allowed limit, rather than on fixed rates allowing for no departure. However, studies are suggested to work out the details of this type of tariff regulation and the role of TAMP in the future.

The present policy of taking over the port labour along with the existing assets is a major deterrent in attracting private investment in major ports. There is urgent need to formulate a clear strategy and action plan to tackle the labour issues.

## **B. Air transport**

In air transport services, scheduled operators do not have route flexibility. The policy of route categorization is problematic as airlines are forced to operate on less lucrative and unviable routes. In fact, the market should be allowed to dictate air service needs, with adequate

freedom to the operators to choose the appropriate aircraft to match the payload and sector distance requirements. Airlines willing to provide services on unviable routes should be allowed to bid on a minimum subsidy basis.

The Government should seriously look into its disinvestment policies. The policy of restricting the equity participation of foreign airlines prevents the domestic airline industry from benefiting through imports of technical know-how, expertise and management practices, which are available globally. The ceiling of 26 per cent on foreign ownership is also not viable since none of the foreign investors is showing an interest in the sector unless the foreign equity participation is raised to 49 per cent.

Last, but not least, one should remember that increased competition and removal of market distortions will enable the country to gain from liberalization and reforms rather than a mere change in hands from public to private.

## **SUMMARY AND CONCLUSIONS**

Maritime and air transport services are important for their intermediate role in the economy and their linkages with many other sectors. Prior to the 1990s, the Government was the main provider of these services and there were various restrictions on private participation. During that period, the performance of these sectors was marked by monopoly-induced inefficiency, low productivity and lack of global competitiveness. With the growth of the Indian economy, the transport sector was finding it extremely difficult to cater to growing domestic demands. To enable air and maritime transport sectors to operate efficiently and regain their competitive strength, the Government embarked upon an ambitious privatization plan in the 1990s, which was a part of the broader reform programme initiated by the Government. It was expected that induction of private investment and management practices would increase efficiency, reduce the financial constraints and speed up the process of adaptation of new technologies.

However, in the absence of a conducive environment for private participation and given the coherent, indecisive and halting nature of



most initiatives, there has been limited progress towards privatization and attracting investments in new infrastructure and consequently, improvement in the productivity, efficiency and competitiveness of these services. The real gains of liberalization can only be achieved through removal of market distortions and enhancement of competition and not through a mere change of ownership from the public to private sector. In line with these axioms, specific measures have been suggested in section III for the improvement of the current situation in the ports and maritime subsectors in India. The Government may consider the implementation of a transparent regulatory structure, which could reduce uncertainties, ensure a level playing field and improve the quality of services taking into account the interest of consumers. Instead of direct intervention, the Government should act as a facilitator, leaving it to the private sector to take operational and management decisions. This will enable the country to achieve the desired objectives of growth, capacity-enhancement and efficiency in both the public and private sectors.

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