



Competition Commission of Pakistan

Government of Pakistan

Policy Note

In Re: Bilateral Air Services Agreement between Pakistan and Saudi Arabia

I. Background

During the proceedings in the PIA Hajj Fare Case, which was concluded on 20 November 2009,¹ the Competition Commission of Pakistan (hereinafter “the Commission”) observed that the Bilateral Air Services Agreement of 1972 between Pakistan and Saudi Arabia (hereinafter the ‘Agreement’) has created a duopoly in the operation of direct scheduled air services between Pakistan and Saudi Arabia by granting exclusive rights to operate direct routes to Pakistan International Airlines (PIA) and Saudi Airlines (SV).

The Commission noted that the Agreement restricted competition on direct routes between the two countries. In addition, the Agreement provided for the establishment of airfares pursuant to mutual consultations between the two designated airlines, thus the Agreement mandates and condones collusion between PIA and SV. This collusion is particularly marked during hajj season when the two airlines set a joint airfare for direct air services under the annual Hajj Agreement. Moreover, the Commission has taken note of the division of the market between PIA and SV and the payment of royalty by PIA to SV, for carrying *Hajjis* in excess of its allocated fifty percent quota. The cost of this royalty to PIA was then spread amongst all PIA Hajjis by way of a higher tariff.

In its Hajj Fare Order, the Commission held that since the Bilateral Air Services Agreement is between two sovereign States, which are not ‘undertakings’ under Section 2(1)(p) of the Competition Ordinance 2009 (the ‘Ordinance’), therefore corrective action could not be initiated against them under the Ordinance. Therefore, the Commission has decided to issue this Policy Note to the Federal Government recommending that the Agreement be amended to remove those concerns.

¹ The Order can be found at <http://192.168.1.200/ccp/images/Downloads/PIA%20Hajj%20Fare%20Final%20Order%20-%2020%20November%202009.pdf>

Before issuing this Note, the Commission also solicited the comments for the Civil Aviation Authority (CAA), which are reproduced in section IV below.

II. The Bilateral Air Services Agreement

Pakistan and Saudi Arabia signed the Agreement on 3 December 1972. The articles of the Agreement which are of concern to the Commission are reproduced below for ease of reference:

Article III (1). *Each Contracting Party shall have the right to designate in writing, one airline for the purpose of operating by virtue of present Agreement, scheduled air services on the routes specified in the appropriate section of the schedule in the Annex to the present Agreement.*

Article VI (2). *There shall be a fair and equal opportunity for the designated airlines to operate the agreed services.*

Article VI (3). *In operating the agreed services the designated airline of each Contracting Party shall take into consideration the interests of the other airline of the other Contracting Party so as not to affect unduly the service which the latter provides on all or part of the route.*

Article VIII (1)

The tariffs to be charged by the airline of one Contracting Party for carriage to and from the territory of the other Contracting Party shall be established at reasonable levels due regard being paid to all relevant factors including cost of operation, reasonable profit, and the tariffs of the other airlines.

Article VIII (2). *The tariffs referred to in paragraph (1) of this Article shall, if possible, be agreed by the designated airlines concerned of both Contracting Parties, in consultation with other airlines operating over the whole or part of the route, and such agreement shall, where possible, be reached through the rate fixing machinery of an international organization or body appointed for that purpose and recognized by the Contracting Party.*

III. Hajj Agreement between PIA and SV

It is pertinent to mention here that PIA and SV annually enter into an agreement for hajj services. According to this agreement, both airlines are a priori be entitled to carry 50% of pilgrimage passengers originating from Pakistan. However the Hajj Agreement allows PIA to carry passengers beyond its 50% quota, subject to the payment of a royalty for each additional passenger to SV.

The recital of the Hajj Agreement 1429H (2008G) between SV and PIA states that SV is willing to forgo its right of equal share 50% of the total revenue pilgrims to PIA.

Article 2 of this Hajj Agreement stipulates that USD 20, 10 and 5 (or USD 40, 20, and 10 respectively, only on SV share i.e., 50% of the total Hajj traffic) will be charged by SV as royalty on every adult, child and infant passenger respectively traveling on PIA for pilgrimage.

IV. Comments by the Civil Aviation Authority

Though its letter dated 5 March 2010, CAA submitted as follows:

- a. Pakistan International Airlines and Saudi Airlines, being the designated airlines of Pakistan and Saudi Arabia, respectively, do enjoy a duopoly over direct air services between the two countries for scheduled, hajj and umra operations. The air services agreement (ASA) between the two countries provides for such arrangement. As for the Hajj operations, PIA and SV share carriage of the Pakistan pilgrims on a 50-50 basis. PIA does not have to pay royalty for its share of carriage of its share of hajj pilgrims; rather royalties are owed when PIA carries Hajj pilgrims out of Saudi Airlines 50% share of the market.
- b. In the last ASA talks in 2002 the issue of multiple airline designations also came under discussion. Saudi Arabia wished to maintain the single airline designation clause, which is foundational of the prevailing duopoly. However, in 2008 there was a shift by Saudi Arabia from restricted to liberal air services agreement policy. Saudi Arabia has since authorized three private airlines Sama Air, NAS Air and Al Wafeer to operate to Pakistan on Temporary Operating Permit (TOP) basis, until this is formalized in the next round of ASA talks. Pakistan has approved the operations of the three airlines to Karachi on TOP basis while maintaining the existing bilateral arrangements. Similarly, Pakistani private airlines Shaheen Air and Air Blue are also keen to commence operations to Saudi Arabia.

V. Competition Concerns

First, the Commission considers Article III (1) to be overly restrictive of competition as it limits the number of airlines flying direct scheduled routes between Saudi Arabia and Pakistan to PIA and SV. No other airline can operate scheduled flights on these routes. This restriction is especially problematic during Hajj season as there are no alternatives for the pilgrims to these two airlines. During the hajj period, higher passenger demand and lower price elasticity create an especial risk of inflated passenger fares unless airlines are encouraged to compete for market share.. Under the prevailing structure, passengers are subjected to uncompetitive pricing and services, and suppressed choice.

Second, the Commission understands that Article VI is used by PIA and SV to divide the market during the Hajj season. PIA informed the Commission during the hearing of the abovementioned case that the conclusion of the Hajj Agreement every year requires the payment of royalty which finds its origin in the said article of the Agreement. The Commission believes that the payment of royalty is unjustified, does not have any commercial rationale, and inflates airfares for all *Hajjis* traveling by PIA regardless of whether they fall within the allocated quota of PIA or not. Also, market division is a serious offence under the Ordinance.

Third, the Commission is of the opinion that Article VIII (2) leads to the fixing of airfares by PIA and SV on the direct routes covered by the agreement. Fixing of prices by competitors in consultation with each other is a *per se*² violation of the Ordinance 2010.

VI. Recommendations

In view of the foregoing anti-competitive concerns, and in light of the fact that additional airlines of Saudi Arabia are already operating into Pakistan on TOP basis, the Commission strongly recommends that the Government of Pakistan take the initiative to enter negotiations with a view to amending the Bilateral Air Service Agreement between Pakistan and Saudi Arabia in line with the following recommendations:

1. That the Agreement be amended to allow multiple airlines to be designated by each State to operate direct scheduled services and hajj services between the two countries.
2. That Article VI (2) and (3), and any other related sub article, be amended to require open and unrestricted competition between all airlines operating between Pakistan and Saudi Arabia, and to abolish any quotas or payment of royalties.
3. That Article VIII (2) be amended to require each airline operating between the two countries to decide its own airfare independently, without interference from either country's aviation authority or airlines.

(DR. JOSEPH WILSON)
Member

ISLAMABAD, THE 18TH OF MAY, 2010.

² Meaning that a violation is established irrespective of the effects of the alleged action