Regulating Aviation in Emerging Markets

The global civil aviation sector has grown rapidly in emerging markets such as the Middle East, Russia, and Asia over the past decade. Yet the regulatory framework in such markets has not kept pace with this growth. Effective regulation is necessary if these regions are to effectively manage the expansion in passengers, cargo, and revenue and ensure safe and secure skies. Leading aviation regulators and civil aviation authorities (CAAs) in emerging markets should look to developed markets for best practices in establishing a clear legislative framework, a set of policy priorities, transparent governance systems, and effective funding strategies.
EMERGING NEEDS IN EMERGING AVIATION MARKETS

In the last decade, the global aviation sector has witnessed a steady increase in passengers and revenue, and emerging markets have seen even faster growth. Take, for instance, the Middle East: From 2005 to 2009, revenue passenger kilometers for the overall industry experienced a compound annual growth rate (CAGR) of 4 percent; in the Middle East, by contrast, the sector grew at 13 percent. Measured by air cargo, the disparity between developed markets and emerging markets is even more striking. The worldwide market for freight ton kilometers actually shrank slightly from 2005 to 2009, with a CAGR of –1 percent; at the same time, to again use the Middle East as an example, air freight volume grew by 10 percent.

To capitalize on this growth, Middle East governments and air service operators have made significant investments to upgrade infrastructure and aircraft fleets. Middle East carriers have ordered more than 500 aircraft, of which approximately 120 are scheduled for delivery in 2010. Some US$30 billion is now slated for investment in airport projects, which will increase the region’s capacity by approximately 400 million passengers annually by 2020. This includes new developments along with major upgrades of several airports in the United Arab Emirates, Bahrain, Qatar, and Saudi Arabia.

Infrastructure and aircraft comprise only half the equation, however. The other necessary element for a rapidly expanding aviation sector is a capable and comprehensive regulatory model to oversee it. To date, the regulatory systems in most emerging markets have simply not kept pace with the sector’s growth, for a number of reasons.

Many of these markets lack a well-defined set of national or regional policies that could define goals and benchmarks for the sector. There are overlapping roles and responsibilities across various aviation-related entities such as regulators, airlines, airports, and municipal and national agencies. This has led to internal conflicts between the regulatory role of CAAs and their role as operators. (For example, air accident investigations and air navigation service providers (ANSPs) are in many cases under the purview of the CAAs themselves.) In some cases, aviation operators can have too much influence—for example, by having executives serve on the boards of agencies ostensibly tasked with regulating the carriers. In other instances, CAAs don’t have sufficient funding to fulfill their responsibilities and must rely on state subsidies.

The lack of transparent and effective governance has also limited the management of airspace and air service agreements across different countries, and influenced by security and military requirements, has constrained the development of new routes, which will throttle airline growth. If the aviation sector in emerging markets continues to grow at current rates, the lack of sufficient regulation and effective governance will only become more acute.
WHAT NEEDS TO BE DONE

To alter this trajectory, national governments and CAAs in these markets must engage in a coordinated effort to restructure the regulatory model based on international best practices. Specifically, responsibilities and roles must be allocated solely to the entities best able to objectively oversee them.

At the highest level of responsibility, these markets must establish an international legislative arm that can provide overall governance and coordinate between national governments within the region. At the next level, national governments must develop policies regarding aviation safety, security, airspace segmentation, environmental standards, and economic policies.

It is crucially important that governments separate regulatory functions from operating functions. Accident investigation bureaus and the ANSPs that manage the national airspace should be removed from the regulatory authority. Air service agreements should be driven by the economic and political agenda of national governments, and it would be beneficial for small countries within the same region to form coalitions to negotiate air service agreements with supranational entities such as the European Commission.

At the CAA level, the proper regulatory framework will ensure that these organizations remain independent vis-à-vis other institutions and aviation operators, in effect freeing them to focus on their core regulatory responsibilities (see Exhibit 1).

Finally, the regulatory framework should include a funding strategy for this regulatory structure, ideally through a variety of fees and charges compatible with the International Civil Aviation Organization’s principles of cost-relatedness, non-discrimination, and transparency, to minimize the requirement of state subsidies to CAAs.

In summary, if these emerging markets are to protect the investments that have been made and spur further growth in the civil aviation sector, they must enhance their regulatory models to become more efficient, transparent, customer-centric, and free of conflicts of interest.

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**Exhibit 1**  
**CAAs Should Cover Six Regulatory Domains**

<table>
<thead>
<tr>
<th>REGULATORY DOMAINS</th>
<th>CATEGORIES</th>
<th>BEST PRACTICES</th>
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| Aviation Safety    | - Safety policies, regulations, and standards  
                    - Inspection and control | - Develop airworthiness and operational regulations  
|                    |                        | - Issue operational licenses |
| Aviation Security  | - Security policies, regulations, and standards  
                    - Passenger screening | - Oversee national aviation security program required  
|                    |                        | by International Civil Aviation Organization (ICAO)  
|                    |                        | - Develop crisis management plan |
| Airspace & Air Navigation | - Airspace oversight and route structuring  
                           - Management of military and civilian airspace | - Approve airspace changes  
| Economic           | - Economic policies and regulations  
                    - Air transport agreements | - Oversee fees and charges of ANSPs and airport operators  
|                    |                        | - Assess economic viability of operators |
| Environmental      | - Noise and emissions standards  
                    - Evolving climate-change requirements | - Issue environmental regulations and certifications, and  
|                    |                        | conduct inspections  
|                    |                        | - Coordinate with local environmental agencies |
| Consumer Protection | - Travel agents and organizer agreements  
                     - Consumer service standards | - Develop passenger protection bill of rights in line with  
|                    |                        | ICAO standards  
|                    |                        | - Oversee process of dealing with consumer complaints |

Source: Booz & Company
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