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FAA downgrade of India highlights deep systemic flaws in India’s aviation safety oversight

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FAA downgrade highlights deep systemic flaws in India's aviation safety oversight. CAPA calls for urgent White Paper to identify depth of problem.

The decision by the US Federal Aviation Administration on 31-Jan-2014 to downgrade India to Category 2 under its International Aviation Safety Assessment (IASA) program is a major embarrassment for one of the world's leading emerging aviation markets. A Category 2 rating signifies an assessment that India's safety oversight regime does not meet international safety standards. India is now one of 16 countries rated as Category 2, out of a total of 88 that have been assessed under IASA; the 16 include Bangladesh, Ghana, Indonesia, the Philippines and Nicaragua.

The direct implications are that Indian carriers are not permitted to launch any new services to the US nor codeshare with US airlines. Existing services may continue. The two Indian carriers which currently operate to the US, Air India and Jet Airways, will also be subject to additional inspections at US airports.

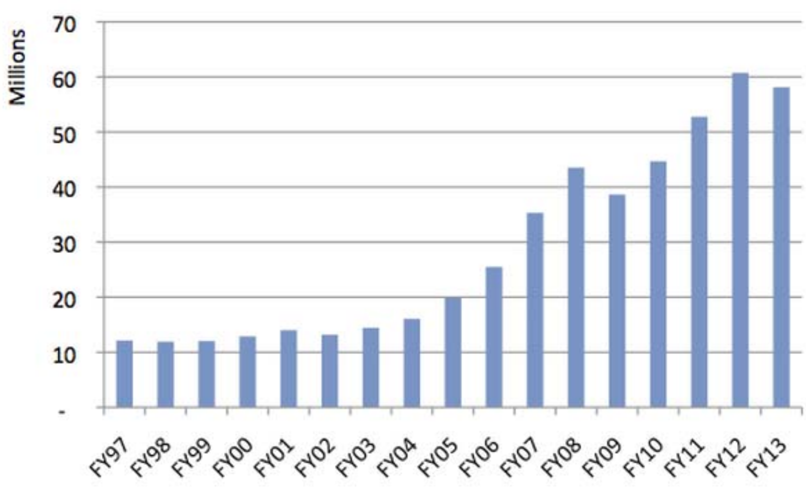
"The FAA's decision is not entirely unexpected. There have been rumblings for several months that a downgrade was on the cards. In fact concerns about the adequacy of safety oversight in India go back several years."

Concerns about safety oversight in India date back to 2009 and earlier

The FAA's decision is not entirely unexpected. There have been rumblings for several months that a downgrade was on the cards. In fact concerns about the adequacy of safety oversight in India go back several years.

In the 50 years from FY1953 to FY2003 the largest number of annual passengers that India's domestic market added in a five year period was 3.6 million. However, FY2004 marked a turning point in Indian aviation as liberalisation of the market and the entry of low cost airlines resulted in unprecedented expansion.

Indian Domestic Airline Traffic FY1997 to FY2013



Source: CAPA - Centre for Aviation, Airports Authority of India

In the five years to FY2008 annual traffic had tripled, surging by an incremental 29.1 million, eight times greater than in any equivalent period before.

The 2004-09 period saw unprecedented growth but the DGCA was severely neglected

Given the historical context of decades of inertia it is not surprising that the regulator struggled at first to keep pace with the sudden growth in the market. However, even once growth had become the new norm insufficient attention was given to strengthening safety oversight.

The DGCA was severely neglected and was not equipped with the resources to handle the demands placed upon it. Without the requisite manpower, and more importantly without the technical skills and expertise, the regulator became weak and over-burdened. The business and general aviation sector had particularly poor safety and security oversight. It was during this period that the seeds of systemic weakness were planted.

"The 2004-2009 period saw unprecedented traffic growth by the DGCA was completely neglected"

Shortcomings were highlighted in 2009 but the ensuing period to date has been one of inaction

In 2009 the FAA, concerned by what it considered to be gross under-staffing, particularly in the Directorate of Airworthiness, threatened to downgrade India to Category II status. There was a brief flurry of activity and following the implementation of several remedial measures and after the Indian Cabinet committed to recruiting more than 500 additional staff, India passed the next FAA audit and retained its Category 1 status.

However, with the threat of a downgrade averted complacency returned and the momentum was lost. The situation has not been helped by a revolving door at the head of the regulatory agency with India now having its fourth Director General in as many years.

"The situation has not been helped by a revolving door at the head of the regulatory agency with India now having its fourth Director General in as many years."

A serious shortage of skilled resources is actually getting worse, there has been no significant recruitment in the last decade

In 2009 the DGCA estimated that it required 928 positions to adequately oversee the level of activity in the sector compared with its actual workforce of 400. Of this shortfall a critical 427 vacancies were for 'A' grade officers. The shortage was particularly acute in the Directorates of Air Worthiness, Flight Standards and Air Safety where there were just 79 'A' grade directors and officers relative to a sanctioned strength of 330.

However most of the 528 additional positions created remain vacant. Since 2009 the DGCA has recruited just 67 full-time employees and 62 consultants and secondees.

"The issue of manpower shortages has been neglected by successive administrations."

Recruitment of Officers to DGCA 2010-2013

Year	Officers Recruited to DGCA
2010	Nil
2011	16
2012	44
2013	7

And traffic in the meantime has increased by more than 50% since 2009, resulting in an ever expanding shortfall. This will only be further exacerbated by expected continued growth. In fact the shortage of manpower at the DGCA has been a recurring issue since the first ICAO audit in 1997. At that time the market was small enough to be manageable and corrective action could have been taken but instead the issue has been neglected by successive administrations.

Suitable job-ready candidates may simply not exist in the numbers required

It is not clear how these vacant positions will be filled in the short-term given the shortage of skilled resources in the market. Even with the best training programmes sufficient qualified inspectors cannot be created overnight especially when less than USD1 million has been spent on training at the DGCA over the last five years. Taking staff on secondment from airlines raises the possibility of a conflict of interest between the regulator and the regulated. And there is also an issue that while industry professionals may have practical experience they may not have the necessary skills sets to apply that experience in a regulatory context.

"It is a telling indictment that there has been no meaningful recruitment at the DGCA in the last decade."

Aside from the cumbersome processes for the hiring of technical staff at the DGCA itself, recruitment in an Indian government agency is also a slow, complex and multi-layered bureaucratic process that requires approvals from the Union Public Service Commission, the Ministry of Law and the Department of Personnel and Training. And with public service pay scales well below that in the airline industry, attracting - and retaining - skills is a major challenge. It is telling that there has been no meaningful recruitment at the DGCA in the last decade.

"The scale of the manpower shortage and the structural challenges which exist with regard to the non-availability of skills and the ability to recruit, train and retain manpower on public service pay scales mean that it could take India years to restore its Category 1 rating"

It should also be noted that the current discussion around the manpower shortfall in the DGCA is taking place with reference to 2009 estimated requirements. Traffic has increased by more than 50% since then and we expect to see traffic triple again over the next decade. Given the scale of the challenge it appears unlikely that the situation can be satisfactorily resolved in the near term.

For these reasons it could take India a long time to restore its Category 1 rating and the harmful implications for India's aviation capability will endure well beyond.

Most other downgraded nations have taken years to regain Category 1 status

In 2010 Mexico lost and regained its Category 1 status within four months, however such a rapid turnaround is the exception rather than the rule. It is understood that the primary area of concern in Mexico was a shortage of check pilots at the regulator due to insufficient funding. However, there was a plentiful supply of qualified resources in the country and the situation was quickly remedied through the allocation of additional budget for the regulator.

"The one silver lining is that the downgrade may act as a serious wake-up call. India must take the opportunity to conduct a comprehensive and independent assessment of aviation safety to identify how deep the problem is and to develop a roadmap for strengthening the institution framework not just for today but for the future."

But in the case of other recent downgrades Israel took four years to get back, the Philippines is yet to do so after five years and likewise Indonesia after more than six years.

For the long term development of the sector safety oversight needs to move beyond meeting minimum requirements

The lack of commitment to safety is a serious concern. India's approach has been one of reacting to threats in order to scrape through and meet minimum requirements – and in this case not even achieving that. The decision to recruit 75 inspectors in Jan-2014 was again done under the threat of a downgrade. Instead the objective should be to pro-actively seek to achieve a best practice safety culture. However this cannot be simply a paper exercise, it requires leadership, talent, discipline, investment and execution.

The one silver lining in the downgrade is that it may act as a serious wake-up call and that India may take the opportunity to conduct a comprehensive White Paper review of the state of aviation safety in the country. Safety must be at the core of every aviation system and there is a critical need for an independent assessment of just how deep the problem is.

Such a review should identify the resource requirements to handle not only the current size of the industry but also develop a structured plan to keep pace with the projected rapid growth over the next decade, rather than constantly play catch-up in response to crises. This review should examine the required legislation, organisations, people, skills and training, and the findings should be should be used to shape a stronger institutional framework around the proposed new Indian Civil Aviation Authority (CAA).

"The downgrade does not necessarily imply that India's airlines are unsafe, but ultimately it is they who will suffer."

A concerted effort to restructure the DGCA has been on hold pending the establishment of a new unified and independent regulator in the form of the CAA. However, the CAA risks simply inheriting the weaknesses of DGCA under a different name. The CAA as currently proposed, which is to be largely appointed by bureaucrats with appeals referred to the Ministry, will deliver neither the independence nor the expertise required. And with administrative issues likely to distract attention during the set-up phase industry risks may increase significantly.

India's airlines will bear the burden of the downgrade

"Star's US members would not be able to place their code on Air India as and when the carrier joins the alliance – something that may actually benefit Lufthansa."

The downgrade does not necessarily imply that India's airlines are unsafe, simply that the regulator is unable to provide appropriate oversight. But ultimately it is the airlines that will suffer and for this reason it is surprising that they have not earlier applied greater pressure on the regulator to strengthen its oversight.

The most immediate consequence is the termination of codeshare agreements that United and American Airlines have with Jet Airways. Indian carriers will not be permitted to increase services to the US until Category 1 status is regained.

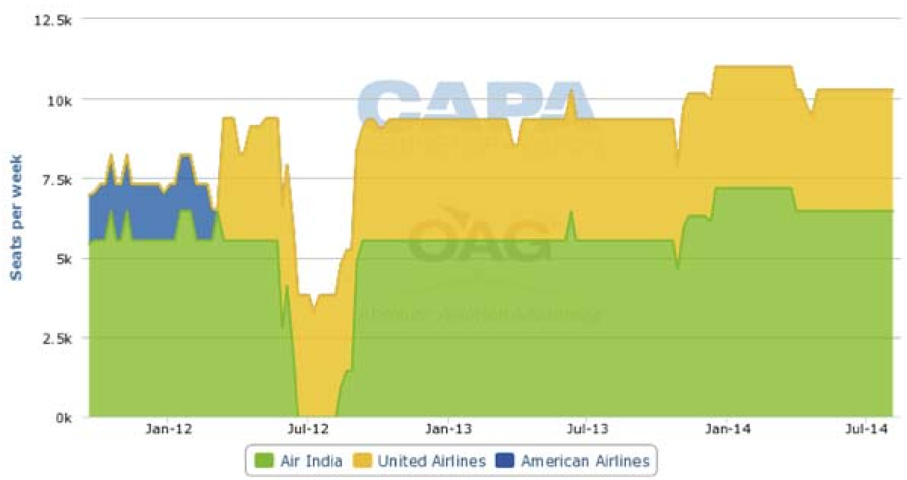
Air India's expected entry into Star unlikely to be impacted

Air India operates daily non-stop services to New York JFK, Newark and Chicago, however the carrier has no current plans to increase capacity to the US and will not be impacted in the short to medium term.

It is unlikely the downgrade will have any implications for Air India's membership of Star Alliance. Global alliances have earlier accepted members from Category 2 nations, as in the case of SkyTeam and Garuda Indonesia. However Star's US members, United Airlines and US Airways would not be able to place their code on Air India - something however that may actually benefit Lufthansa. United Airlines currently operates its own metal to Delhi and Mumbai, but serves offline metros such as Bangalore and Chennai over Frankfurt on a code share basis with Lufthansa.

Air India's expected entry to Star Alliance could potentially have shifted some of this traffic to United's services to Delhi and Mumbai where passengers would have connected domestically with Air India. Similarly, with Air India prevented from expanding services to the US the carrier may be more likely to expand its presence beyond its three current gateways in partnership with Lufthansa over Frankfurt. Either way, the development means Star and its members will have a range of options to explore and indeed curtailment of Air India's growth on India-US routes may suit Star Alliance well.

Non-Stop Weekly Seat Capacity between India and the United States



Source: CAPA, OAG

Jet Airways is likely to be the most impacted by the downgrade; its US expansion plans will have to be placed on hold

Jet Airways on the other hand, which currently operates a daily service to Newark via Brussels, will now need to re-think its network expansion plans. Following the acquisition of a 24% stake in Jet Airways by Etihad, Jet was in the process of restructuring and expanding its US route network. Abu Dhabi was to replace Brussels as Jet's North American hub, and on 15-Jan-2014 Jet had announced plans to launch services to New York JFK effective 1-May-2014.

"Jet Airways is likely to be the most impacted by the downgrade; its US expansion plans will have to be placed on hold."

A Chicago service was also planned for later in the year. Neither of these new routes can proceed using Jet Airways metal in light of the downgrade. The absence of a clear timeline as to when Category 1 status could be restored will be frustrating for Jet Airways from a fleet and network planning perspective.

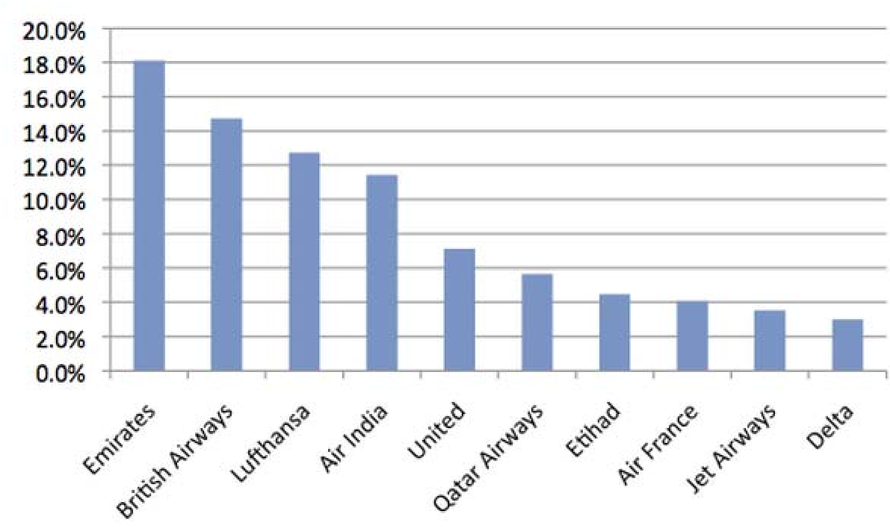
Although Jet only operates a single daily service to the US at present this market was an important part of the carrier's network expansion plans. The India-US market is one of the largest international origin-destination routes to/from India accounting for approximately 2 million passengers per annum in each direction, close to 10% of international traffic in India.

"The absence of a clear timeline as to when Category 1 could be restored will be frustrating for Jet Airways from a fleet and network planning perspective."

Due to the fragmented nature of the market, the cost of operating very long haul non-stop services and the relative weakness of Indian carriers, their share of the market in FY2013 was estimated at just 15%. More than 70% of traffic is carried by sixth freedom European and Gulf carriers, with the balance by US carriers. But the partnership with Etihad, which included the ability to leverage the recently opened US Pre-Clearance facility in Abu Dhabi, represented an opportunity to jointly offer more than 100 India-US city pairs on a one-stop basis over the next three years.

Much of this, fortunately, can still be achieved using Etihad rather than Jet metal to the US; however it remains to be seen how aircraft and routes are re-allocated within the Etihad family.

Airline Share of India-US Origin Traffic in FY2013



Source: CAPA, AirportIS

Tata-SIA faces a fresh regulatory hurdle to its international network plans

When the Tata Group and Singapore Airlines announced their planned full service joint venture in Sep-2013 they did so in a regulatory environment which limited the start-up carrier to operating only domestic services for the first five years. However with most domestic carriers bleeding and only a limited number of domestic routes which can support a full service airline, international routes were clearly the ultimate objective.

"An opportunity was emerging for a well-funded, premium Indian carrier such as Tata-SIA operating non-stop services to global destinations. The US would surely have been an important component of those network plans."

With a weak Air India and with Jet Airways increasingly focused on one-stop operations via Abu Dhabi, an opportunity was emerging for a well-funded, premium Indian carrier operating non-stop services to global destinations which would have been positive for India's aviation interests and helped to re-balance the growth of Gulf carriers in the market. The US would surely have been an important component of those network plans. Apart from Indian origin and destination traffic there was also potential for Singapore Airlines to interline with Tata-SIA in Delhi to access the US East Coast, something it has struggled to do viably on a non-stop basis from Singapore, recently withdrawing its all-business class non-stop operation. Routings via Delhi are very efficient, with Singapore-Delhi-New York being only 3.8% further than the non-stop distance.

"Tata-SIA may soon be in a position where the proposed carrier would be permitted to launch international services – but not to the US."

However the carrier's international ambitions are predicated on a lifting of the 5 year/20 aircraft rule. It was expected that this reform would take place in late 2013. This did not happen but more recently the Ministry of Civil Aviation has stated that a Cabinet note to this effect has been prepared and this discriminatory regulation could finally be lifted in Feb-2014.

However, Tata-SIA may soon be in a position where the proposed carrier would be permitted to launch international services - but not to the US. This will have significant implications for its fleet and network plans.

India's airlines are likely to face increased costs and challenges as a result of the downgrade

In addition the impact of the FAAs decision is that all Indian carriers could potentially suffer from higher lease rates, more stringent maintenance covenants and increased insurance premiums as a result of a perceived increase in risks. And passengers may be less inclined to fly on Indian carriers where they have a choice, particularly US citizens. These heightened risks may also impact investor interest in the sector at a time when capital raising is already a challenge.

"All Indian carriers could potentially suffer from higher lease rates, more stringent maintenance covenants and increased insurance premiums as a result of a perceived increase in risks."

The possibility also exists that other jurisdictions may raise their own concerns about safety oversight in India. Restrictions on operating to Europe or Asia would have a much greater impact on Indian carriers due to their relatively larger operations to these markets compared with the US. However, with the US having already made its move, for political reasons other nations may prefer not to take further action. The European Union has been engaged on a project to support the institutional strengthening of the DGCA and the FAA is also ready to assist.

Solving the problem will be complex; finding and/or training adequately qualified bureaucrats is a hugely challenging task. The first step along the route to improvement is however to confront the reality of the situation and its awesomely negative impact on India's aviation resource.

"The possibility exists that other jurisdictions may raise their own concerns about safety oversight in India, which could have a much greater impact on Indian carriers."

The downgrade is a matter which rests solely at the government's door; at least the FAA's action will force a recognition of India's regulatory shortcomings. The next step is to do something about it, but few will be holding their breath in anticipation.

With a general election imminent, there is however a cause that would make restoring India's aviation credibility a serious goal.

An urgent, comprehensive and independent White Paper on the state of aviation safety is critical to understand the depth of the problem. Only then can appropriate long-term solutions be developed.

About CAPA India Aviation Monitor

CAPA India Aviation Monitor - published 8 times a year - provides unique insights which are not available elsewhere, into the financial, commercial, operational performance and fleet plans of listed and unlisted carriers; airport operator and infrastructure developments; domestic and international traffic, yield and cost analysis; and the latest policy and regulatory updates. Subscribers also receive appendices consisting of detailed market data.

Aviation businesses with millions of dollars of value at risk cannot afford to be caught out by unexpected developments in a fluid market.

These monitors are invaluable for any organisation with exposure to the Indian market, providing rigorous analysis and a forward perspective on the direction of the sector, leveraging CAPA's extensive on-the-ground presence and research capabilities in India.

CAPA India also offers a range of additional advisory and research services e.g.:

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