

**Title of the subject:**

**Improvement of Regulation of Georgian Aviation Market as Crime  
Prevention Instrument**

**(Summary)**

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The study aims to analyze the reasons of economic crime on the aviation market of Georgia and to develop recommendations for the eradication of regulation problems on the market.

The study highlights the processes of the recent ten years that resulted in withdrawal of the State from the civil aviation market. Actually Georgian aviation market is not regulated; in these circumstances unjustified greenhouse conditions are created for the flag carrier company.

Therefore, it is logical that reaching partnership relationships with foreign companies is a “traditional” problem. The processes that took place resulted in the monopolization of the aviation market, thus facilitating of development of the environment supportive to economic crime. Resulting from inefficient management of these processes that served unhealthy financial interests of a small group of individuals Georgia missed the opportunity to become a regional leader in the civil aviation sector.

Even on an example of the closure of three Georgian airlines the conclusion could be made that the Civil Aviation Administration, especially the Ministry of Transport and Communications (the State in general) undertook unjustified illegal efforts to assure operations of only one Georgian airline on the market, as this would provide them with more opportunities for corruptive deals and uncontrollability. Therefore, at the first stage they allowed *Airzena Georgian Airlines* to dominate market by dismissing not only foreign airlines, but also Georgian companies. For this reason the State initially deprived the state company *Georgian Airlines*, more or less viable at that period, of property and personnel, and then of the flight permit to particular destinations. In order to achieve above-mentioned goal they enforced the state airline to stop operations and artificially turned it bankrupt.

Because of the collapse of the unified soviet aviation infrastructure air space of Georgia has actually been “locked”. Small aviation companies founded at this period soon ceased functioning due to economic situation, conflict in Abkhazia, small size of aviation market and other factors; whilst the state aviation company *Sakartvelos Aviakhazebi (Georgian Airlines)*, created later, went bankrupt and stopped operations due to artificially initiated processes.

The study provides the analysis of following processes that took place in the civil aviation in recent years:

- Failure of the project of unification of three Georgian airlines through participation share of the State;
- Forced bankruptcy of the state airline *Sakartvelos Aviakhazebi (Georgian Airlines)*.
- Awarding of the status of a flag carrier to the company *Airzena Georgian Airlines*;
- Withdrawal of competitors (including foreign airlines) from the market;
- Violation of regulatory function.

Firstly, the fact of the failure of the project aiming to unify three Georgian airlines is analyzed. In order to implement this project and ensure participation of the State in a new airline the competition for the privatization of the state company *Georgian Airlines* was suspended.

Eventually the unification of the state airline, on the one hand, and private companies *Airzena* and *Air Georgia*, on the other hand, did not take place. Private airlines *Airzena* and *Air Georgia* founded a private company *Airzena Georgian Airlines* without the participation of the state airline. Ignoring legislation of Georgia and economic (market) expediency, the new airline was awarded a flag carrier status. Serving the interests of one particular “business” group, so called “flag carrier” status facilitated many undesirable processes and the formation of criminal

environment. Mentioned status is not recognized on the world aviation market and actually stands up against Georgian laws “On Licensing” and “On Monopolistic Activities and Competition”.

It should be mentioned that the requirements of the provision “On awarding a status of Georgian flag carrier” were and are still violated by the airline; according to the article 9 of the provision violation is the basis for the deprivation of the flag carrier status.

The enforcement of intergovernmental agreements through approved procedures has never been considered appropriately in the aviation sector of Georgia. This lately caused problems to foreign companies. Apart from the introduction of completely unjustified and corruptive so called “flag carrier status”, obligatory payment of compensatory royalties were established for foreign companies – the practice totally unacceptable in the aviation sector worldwide. Payment of so called “regulation fee” regarded illegal by the Constitutional Court was still practiced, etc.

Travel tariffs established monopolistically by the flag carrier company (the tariffs were not subject to any kind, even symbolic “revision”) were very high, whereas established “rules of game” (considered in the study) made absolutely impossible the implementation of projects similar to those common in Europe. Europe experiences the boom of cheap transfers (especially advantageous for tourists). E.g. price of flights on Moscow-Cologne and Moscow-Berlin routes is 50-100 Euros (one way). According to *Deutsche Welle* 15% of tickets will be sold at even cheaper prices – 19-20 Euros.

Failure to organize an investment competition and to implement the project of unification of three airlines, as well as awarding the flag carrier status to *Airzena Georgian Airlines* (through support of governmental institutions) state airline went bankrupt artificially. This was the first important step towards the monopolization of the market.

Besides, in case of one-sided operations of foreign airlines on Georgian aviation market these companies had to pay compulsory compensation in favor of the national carrier based on a

commercial agreement; this rule is regarded unpopular on the world aviation market. Mentioned rule in complex with other factors in some way caused the increase of travel costs.

As it was mentioned foreign carriers starting scheduled services to Georgia on the basis of inter-governmental agreements or temporary permits also faced serious difficulties. Many of them left Georgia at different periods. Tax problems and other legal issues were recognized as reasons for leaving Georgian aviation market by British, Turkish and German companies, while main reason for leaving was the failure to achieve an agreement with the national flag carrier. As a result of lobbying unjustified, rather obvious interests of the flag carrier the Parliament of Georgia made a resolution causing the withdrawal of foreign airlines from the market. This actually was a final step towards the monopolization of Georgian aviation market.

Disorder on the market, activation of totally unjustified legal (financial) mechanisms, and the State for years managing processes from dictation of one company (this is also reflected in the study), by 2002 prepared the ground for driving foreign companies out of Georgian aviation market and for the monopolization of the market in general. Based on existing situation, at the final stage this was supplemented by the coercion on behalf of the State (justifying this step by agreements not currently in force).

The study considers problems related to use of “6<sup>th</sup> freedom of air” and current legal (normative) base in force in the civil aviation sector. Existing methods and principles of ratification are also reviewed. By means of practical examples it is emphasized that these principles are not actually put into practice; consequently, it is impossible to accomplish relevant objectives. A passenger is actually defenseless and has fewer options. The role of administration in the regulation of these processes is minimal and inefficient. In accordance with inter-governmental agreements transportation/transfer tariffs are approved only formally.

We believe that in competition with foreign airlines it is important and essential to support a national carrier. This is an accepted practice in most of the countries worldwide. Though the study shows that competition with powerful foreign airlines in order to “save” the national carrier is carried out by means of high (or inadequate) tariffs and other unfair and unacceptable conditions offered by the latter. This process is beyond the state regulation. During fixing of prices profitability coefficient is increased, while coefficient of load and of other indicators is reduced. This determines unjustified tariff rates that source uncontrolled financial profits of a group of people. It is obvious that the national flag carrier turned by the State into the market monopolist and almighty entity had lobbyists in legislative and executive power.

So called “Travel fee” should also be mentioned in relation to tariffs. It was established to cover the reconstruction credit from the European Bank; it made ticket prices even higher as passengers had to cover it for several years. So called “regulation fee” envisaged by Georgian legislation is also related to this issue - it was regarded unconstitutional by the Constitutional Court of Georgia; however, passengers still have to pay it. This sum is transferred to the account of the regulatory body. The decisions of the Constitutional Court are analyzed in this regard.

The subject of tariffs is to the certain extent related to the consideration of expediency of construction of the new airport in Tbilisi. The construction should be financed by loan (or by attracting an investment) with the similar results for the passenger, who would still have to cover the loan. Simultaneously, no ways are sought to increase Tbilisi airport revenues. Suspicion is aroused that the construction of new airports is only an end in itself, as at this stage it is obvious that existing and expected increase of passenger flow does not guarantee profitable operation of Georgian airports.

International practice and trends are analyzed in the study in relation to situation in Georgia.

Recommendations developed in the study almost fully reflect the ways to overcome difficulties of the sector, including corruption. This is especially attuned to so called “open air principle” (we consider this as one of our main recommendations); implementation of this principle would have eliminated many corruptive practices. Finally, following recommendations are suggested as a result of the study:

Following recommendations are provided at the end of the study:

- ✓ **Expediency of the issue of flag carrier status should be reviewed;**
- ✓ **Established compensation payment rule should be reviewed;**
- ✓ **Full inventory of international treaties concluded by the State of Georgia in the civil aviation sector should be made;**
- ✓ **Regulatory functions and competencies of the Civil Aviation Administration should be clarified;**
- ✓ **Methodological principles of tariff regulation should be practically implemented;**
- ✓ **Following issues should be considered the expediency of new airport constructions, privatization of existing infrastructure (transfer by concession), investment possibilities;**
- ✓ **Regulation of Georgian civil aviation market should be subject to the so called “Open air” principle;**
- ✓ **The decision of the Constitutional Court regarding “Regulation fee” should be executed.**