

The ASEAN Single Aviation Market: Liberalizing the Airline Industry

By ALAN KHEE-JIN TAN

Key Issues for Policy:

- *Facilitating cost reduction and efficiencies for all airline operations, full-service carriers and low-cost carriers;*
- *Committing to overcome infrastructural, human capacity and other constraints;*
- *Continuing to liberalize market access and ownership/control rules;*
- *Establishing an ASEAN regulator to oversee and enforce harmonized standards;*
- *Fostering a united ASEAN negotiating stand vis-à-vis other countries and blocs.*

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This *Policy Brief* presents an overview of the barriers facing air transport liberalization in ASEAN. It lays out the policies that governments should undertake to overcome these barriers, particularly in light of rapid changes in the aviation industry. It also assesses the incomplete or unfinished nature of the ASEAN Single Aviation Market (ASAM) that necessitates further liberalizing steps beyond 2015. In particular, more meaningful market access and ownership/control relaxations must be pursued to deal with the increasing competition from airlines outside the region. A united external policy is also required to enhance ASEAN's negotiating position vis-à-vis other countries and blocs.

Introduction

The Association of Southeast Asian Nations (ASEAN) has identified a 2015 deadline to establish an ASEAN Single Aviation Market (ASAM) for the liberalization of air transport services within the region. The goal is to have the ASAM in place by the time the proposed ASEAN Economic Community (AEC) takes effect in 2015. However, regional governments have not kept up with the rapid changes in the airline industry, and infrastructure and manpower constraints abound. In addition, the ASAM liberalization agenda remains fairly modest. More ambitious intra-ASEAN market access and ownership/control relaxations are required beyond 2015 if ASEAN airlines are to compete effectively against their rivals from bigger markets.

Rapid Changes for ASEAN Aviation

Infrastructure and Human Capital Constraints

Low-cost carrier (LCC) operations now account for more than or nearly half of all airline capacity (international plus domestic) in the Philippines (61%), Indonesia (53%) and Malaysia (48%). The next highest LCC penetration rates in ASEAN are 30 percent for Singapore, 29 percent for Thailand and 21 percent for Viet Nam. With strong economic growth projected for the region, the LCCs' share of capacity

is expected to increase even more dramatically in the next decade.

Airports in ASEAN have seen passenger traffic and aircraft movements grow robustly on the back of LCC operations, even as the shares of long-haul flights and full service carriers (FSCs) decline. Yet, on the whole, ASEAN governments have not made adequate policy changes to accommodate the LCC phenomenon. In particular, the LCCs' infrastructure needs are not being addressed quickly enough. Airports or terminals dedicated to LCC operations remain the exception, with priority still being placed on FSCs and national carriers. Policies intended to spur LCC travel by making it more cost-efficient and accessible are also lacking, e.g., reduced airport and user charges and passenger taxes.

Major ASEAN airports like Jakarta Soekarno-Hatta, Manila Ninoy Aquino and Bangkok Suvarnabhumi have now exceeded their intended capacity. This has resulted in increasing congestion and longer delays. The re-opening of Bangkok's Don Mueang Airport to cater largely to LCC operations is a reminder of the infrastructure constraints posed by the LCCs' spectacular growth. Governments must thus pay more attention to airport capacity investments, particularly those relevant to LCC operations.

The LCCs' huge aircraft orders compound the problem. Between them, the Lion Air and AirAsia groups alone have more than 1,000 aircrafts on order. Other LCCs like Cebu Pacific, Tiger Air, Nok, Jetstar and VietJet are expanding rapidly as well. Newer LCC subsidiaries like Malindo, Thai Lion, Thai VietJet and Nok Scoot have also been established. With increasing market access liberalization within ASEAN, most of the new planes will end up servicing ASEAN skies. Quite apart from whether the skies are truly open, there is now a huge gap between aircraft orders and infrastructure expansion efforts.

The projected growth in aviation will also impose tremendous pressure on the provision of pilots and maintenance personnel. The industry

projects that the Asia-Pacific region alone will require 185,000 more pilots and 243,500 maintenance personnel for the next 20 years. The region will thus benefit from a harmonized crew training and licensing programme. Training centres should receive common accreditation to ensure harmonized standards and quality. Overall, the demand for aviation professionals should be managed and met on a regional, rather than national, basis. This way, manpower can be positioned anywhere in the region as market demand dictates, with commonly agreed certification standards recognized by all states. This reduces costs and increases efficiencies all around.

A Common ASEAN Regulator?

Beyond 2015, ASAM should steer the region towards a common regulator to oversee technical matters. Initially, such a regulator might take the form of a Joint Aviation Committee comprising the member states' civil aviation authorities. The regulator could take charge of legislating and enforcing harmonized standards relating to air traffic management (ATM), safety, security and other technical matters in line with International Civil Aviation Organization (ICAO) requirements.

Notably, standards need not be uniform, but harmonized to a sufficient degree to allow cross-border enforcement co-operation. For example, a harmonized set of safety rules can be applied by all member states' national authorities, and inspections conducted by one authority should be accepted by others as adequate. This avoids duplication in checks and enforcement. Of course, this will be challenging as it requires the enhancement of capabilities across all member states.

A United Stand for External Relations

There is also a critical need for an increasingly integrated ASEAN to craft a common external aviation policy. This involves coordinating member states' positions to strengthen their collective stand when negotiating with bigger trading partners such as China, India, Japan, the European

Union (EU) and the United States (US). A common stand would be critical for issues like aircraft carbon emissions and negotiating market access rights with other countries as can be seen in the succeeding sections.

The ASAM and Market Access Barriers

More pressingly, ASEAN has its ASAM or “open skies” ambition for implementation by 2015 consistent with the AEC. To this end, three multilateral agreements have been adopted to provide unlimited third, fourth and fifth freedom operations within the region. State parties to those agreements agree to provide for the following operations to become unlimited or unconstrained in frequency, capacity and aircraft type used:

- i. “Third freedom” - the right of carriers designated by State A to carry passengers, cargo and baggage for profit from points in State A to points in State B.
Example: Thai Airways (TG) operation from Bangkok to Singapore, Phuket to Bali, or Chiang Mai to Hanoi.
- ii. “Fourth freedom” - the corresponding right in the reverse direction.
Example: The same TG flight returning from Singapore to Bangkok, Bali to Phuket, or Hanoi to Chiang Mai.
- iii. “Fifth freedom” - the same right but with an additional right to make a stopover in State C to discharge and take on new traffic for profit.
Example: TG operation between Bangkok and Singapore but with a stopover in Kuala Lumpur in both directions to discharge and take on traffic.

The ASEAN multilateral agreements, their scope and the relevant state parties (Table I) are as follows:

Table I. Multilateral Agreements Towards the Implementation of ASAM

Multilateral Agreement	Scope	State
2009 Multilateral Agreement on Air Services (MAAS) Protocol 5 Protocol 6 Protocols 1 to 4	Unlimited third & fourth freedom between capital cities (A’s carriers between A’s capital and another capital) E.g., Thai Airways’ (TG) Bangkok-Hanoi & vice versa Unlimited fifth freedom between capital cities (A’s carriers from A’s capital to C’s capital via B’s capital) E.g., TG Bangkok-Kuala Lumpur-Singapore & vice versa Limited impact: covering mainly secondary cities in growth areas (sub-regions) straddling borders of neighbouring states. E.g. Cambodia, Lao PDR, Myanmar and Viet Nam (CLMV) Agreement	All <u>except</u> Indonesia and the Philippines All <u>except</u> Indonesia and the Philippines All 10 member states
2010 Multilateral Agreement for the Full Liberalization of Passenger Air Services (MAFLPAS) Protocol 1 Protocol 2	Unlimited third & fourth freedom between all cities (A’s carriers from A’s capital to B’s non-capital, A’s non-capital to B’s capital & A’s non-capital to B’s non-capital) E.g., TG Bangkok-Cebu, Phuket-Manila, Phuket-Cebu Unlimited fifth freedom between all cities (except capital-capital-capital) E.g., TG Phuket-Ho Chi Minh-Cebu, Phuket-Ho Chi Minh-Manila, Phuket-Hanoi-Cebu, Phuket-Hanoi-Manila, Bangkok-Hanoi-Cebu, Bangkok-Ho Chi Minh-Manila, Bangkok-Ho Chi Minh-Cebu	All <u>except</u> Indonesia and Lao PDR All <u>except</u> Indonesia and Lao PDR
2009 Multilateral Agreement for the Full Liberalization of Air Freight Services (MAFLAFS) Protocol 1 Protocol 2	Unlimited third, fourth and fifth freedom between designated points E.g., Thai Airways Cargo’s Bangkok-Clark, Bangkok-Vientiane-Hanoi routes Unlimited third, fourth and fifth freedom between all points with international airports E.g., Thai Airways Cargo’s Bangkok-Singapore, Bangkok-Singapore-Manila routes	All <u>except</u> Indonesia All <u>except</u> Indonesia

Table 2 shows in detail the subregions and their respective designated points under Protocols 1 to 4 of the MAAS while Table 3 lists the cities designated under Protocols 5 and 6 also of the MAAS.

Some Member States are Not Parties

A key barrier is that several member states, namely Indonesia, the Philippines and Lao PDR have yet to ratify all the above Protocols. The most significant of these is Indonesia, given its huge size and air travel market. Apart from the more limited

Table 2. MAAS Protocols 1 to 4 and Designated Points

Sub-region	Member States	Protocol 1: Third & Fourth Freedom Within Sub-region	Protocol 2: Fifth Freedom Within Sub-region	Protocol 3: Third & Fourth Freedom Between Sub-regions	Protocol 4: Fifth Freedom Between Sub-regions
BIMP-EAGA	Brunei	Bandar Seri Begawan	Bandar Seri Begawan	Bandar Seri Begawan	Bandar Seri Begawan
	Indonesia	Balikpapan Manado Pontianak Tarakan	Balikpapan Manado Pontianak Tarakan	Balikpapan Manado	Balikpapan Manado
	Malaysia	Kota Kinabalu Labuan Kuching Miri	Kota Kinabalu Labuan Kuching Miri	Labuan Miri	Labuan Miri
	Philippines	Davao General Santos Puerto Princesa Zamboanga	Davao General Santos Puerto Princesa Zamboanga	Davao General Santos Puerto Princesa Zamboanga	Davao Zamboanga
CLMV	Cambodia	Phnom Penh	Phnom Penh	Phnom Penh	Phnom Penh
	Lao PDR	Vientiane Luang Phabang Pakse	Vientiane Luang Phabang Pakse	Vientiane Luang Phabang Pakse	Vientiane Luang Phabang Pakse
	Myanmar	Yangon Mandalay	Yangon Mandalay	Yangon Mandalay	Yangon Mandalay
	Viet Nam	Ha Noi Ho Chi Minh City Da Nang Dien Bien Phu Phu Bai Cat Bi Lien Khuong	Ha Noi Ho Chi Minh City Da Nang Dien Bien Phu Phu Bai Cat Bi Lien Khuong	Ha Noi Da Nang Dien Bien Phu Phu Bai Cat Bi Lien Khuong	Ha Noi Da Nang Dien Bien Phu Phu Bai Cat Bi Lien Khuong
IMS-GT	Indonesia	NOT APPLICABLE			
	Malaysia				
	Singapore				
IMT-GT	Indonesia	Medan Padang Banda Aceh Nias	Medan Padang Banda Aceh Nias	Medan Padang	Medan Padang
	Malaysia	Penang Langkawi Alor Star Ipoh Kota Bharu	Penang Langkawi Alor Star Ipoh Kota Bharu	Alor Star Ipoh	Alor Star Ipoh
	Thailand	Hat Yai Narathiwat Pattani Trang Nakon Si Thammarat	Hat Yai Narathiwat Pattani Trang Nakon Si Thammarat	Hat Yai Narathiwat Pattani Trang Nakon Si Thammarat	Hat Yai Narathiwat Pattani Trang Nakon Si Thammarat

Source: MAAS Implementing Protocols 1 to 4.

Table 3. MAAS Protocols 5 and 6 and Designated Capital Cities

Member States	Protocol 5: Third & Fourth Freedom Between ASEAN Capital Cities	Protocol 6: Fifth Freedom Between ASEAN Capital Cities
Brunei	Bandar Seri Begawan	
Cambodia	Phnom Penh	
Indonesia	Jakarta	
Lao PDR	Vientiane	
Malaysia	Kuala Lumpur	
Myanmar	Yangon	
Philippines	Manila	
Singapore	Singapore	
Thailand	Bangkok	
Viet Nam	Ha Noi	

Source: MAAS Implementing Protocols 5 and 6.

MAAS Protocols 1 to 4, Indonesia has not accepted any of the other Protocols. Indonesia's reluctance is partly due to its carriers lobbying to continue protecting their markets. Their concern is that the stronger airlines from neighbouring member states will dominate international routes into and out of Indonesia.

There is, however, compelling economics-based evidence that liberalization brings significant benefits to the overall Indonesian economy. In particular, travellers and exporters enjoy more competition among airline providers and consequently increased choices and lower fares and freight rates. There are also significant benefits for tourism, travel-related businesses and inward foreign investment. While the local airlines are likely to lose market share as a result of increased access for foreign carriers, they will also benefit from a significant increase in volumes carried and revenues generated on the whole.

To address the Indonesian concerns, the ASEAN Secretariat, the member states and their carriers must continue to engage the Indonesian government and carriers to encourage them to accept the ASEAN agreements. Co-operative ventures with Indonesian carriers (e.g., code-sharing

and joint ventures) should be pursued to provide incentives for them to support ASEAN's liberalization moves. In time, as Indonesian carriers such as Garuda and Lion become more competitive and grow their own overseas operations, they will require greater access into other ASEAN states as well and will thus embrace greater liberalization.

Seventh Freedom and Domestic Operations Remain Prohibited

A further problem is that ASAM stops with third, fourth and fifth freedom relaxations. Seventh freedom and domestic operations by foreign carriers are not yet contemplated. Hence, a Thai carrier cannot connect a point in Malaysia and a point in Indonesia without the flight originating and terminating in Thailand. Similarly, it cannot connect two domestic points within Indonesia. The ASAM is thus incomplete and risks becoming "single" only in name. Consequently, airline operations remain restricted by artificial barriers erected by governments despite the economic justifications for removing them.

One short-term solution is for member states to fully endorse fifth freedom operations (i.e., A's carrier operating from A to B to C), even if they

resemble seventh freedom operations. To illustrate, if a Thai carrier operates from Bangkok to Singapore via Hanoi, the routing will effectively resemble a seventh freedom operation for the Hanoi-Singapore sector. This is because few passengers from Bangkok will take the circuitous route via Hanoi to Singapore. Indeed, the Bangkok passengers will effectively disembark in Hanoi, to be replaced by a fresh load of passengers bound for Singapore.

Such operations are technically permitted by the ASEAN agreements since there are no directionality or capacity conditions. As they are wholly consistent with ASAM's liberalizing spirit, requests for such operations should be approved. Indeed, member states should adopt an interpretation of the agreements to allow such operations explicitly. Member states should also work to phase out seventh freedom restrictions totally as well as to allow domestic carriage in progressive phases. There should be a phased timetable to allow the commencement of seventh freedom and domestic services by other ASEAN carriers, beginning possibly with points hitherto not connected by direct flights, points that are not capital cities and eventually, points that are capital cities.

ASEAN Disadvantage Vis-à-vis External Carriers

Maintaining seventh freedom restrictions will also disadvantage the region's carriers vis-à-vis those from outside the region. To illustrate, ASEAN has already adopted an Air Transport Agreement (ATA) with China that replaces the individual air services agreements between member state parties and China. This ATA provides unlimited third and fourth freedom operations. Thus, a Thai carrier can penetrate all Chinese points, though only from points in Thailand. Conversely, a Chinese carrier can connect all points in its own "backyard" (China) with all points in ASEAN member states accepting the ATA. This is possible because the Chinese carriers have a unified "backyard" of their own, while the ASEAN carriers do not.

This presents a serious network imbalance that can only be rectified by the ASEAN states treating their own "backyard" as a true common market. The Thai carrier must be allowed to connect Viet Nam, Singapore, Indonesia and indeed all of ASEAN with China. To do this, the ASEAN member states must grant each other's carriers the seventh freedom to connect two points outside the carrier's home state.

Hence, the internal ASEAN market should first be complete before the region starts negotiating with others. The problem arises because ASEAN lacks a mechanism like the EU's which can compel member states to prioritize the regional interest over national individual interests. Moreover, the region's biggest economy and natural leader for negotiations, Indonesia, remains wary of intra-ASEAN liberalization. At its core, the challenge is the uneven level of development and competitiveness among member states and their airlines. The problem must be redressed before the region and its airlines lose their relative competitiveness and become disadvantaged against airlines from outside the region.

ASAM and Ownership and Control Barriers

To add to the market access barriers, ownership and control restrictions remain as well. In ASEAN, airlines are subject to the traditional "substantial ownership and effective control" rule. Hence, carriers must be majority-owned (beyond 50%) by their designating state's nationals and foreign interests are restricted to minority shares. In some states like the Philippines, the foreign investor's share is capped at an even lower level of 40 percent. Such rules hamper the raising of capital from across the region to establish new airlines or to re-capitalize existing ones. As such, they hurt airlines in developing member states that especially need foreign investments.

The ASEAN agreements actually allow alternative ownership and control regimes. In particular, they provide for the ASEAN "Community

Carrier”, in which majority ownership can be held by ASEAN nationals taken together. Hence, a Myanmar-registered carrier need not be majority-owned by Myanmar nationals, but can be owned by 20 percent Myanmar, 20 percent Malaysian and 11 percent Vietnamese interests. Majority ownership can thus be spread out among ASEAN interests as long as effective regulatory control (e.g., for safety and security matters) remains with the Myanmar authorities. This is a welcome innovation that provides incentives for capital to be raised region-wide for the airline sector.

However, the ASEAN agreements also provide that individual member states retain the right to reject a Community Carrier that wishes to operate to those states. Hence, any member state can withhold market access rights from the above Community Carrier, ostensibly to continue protecting its own airlines. This robs the ASEAN agreements of their liberalizing intent.

One way to lift this barrier is for member states to retain the traditional “substantial ownership and effective control” rule for their own carriers *only*, if they so wish. For other ASEAN carriers, the community model should be allowed and welcomed, with no threat of denying market access. This will reassure airline investors of the Community Carrier’s long-term sustainability. Eventually, all restrictions on ownership and control by ASEAN nationals, even for member states’ own airlines, should be phased out. This can only be logical if a true “single” aviation market is to emerge.

Overall, liberalizing market access and ownership/control rules should be pursued as a package. Otherwise, it is meaningless to provide for a Community Carrier if this carrier’s market access to points in ASEAN can be constrained by individual states.

Conclusion

Policymakers must re-think their strategies for ASEAN aviation in view of the rapidly changing dynamics. The following priorities should therefore guide policymaking:

- Facilitating cost reduction and efficiencies for all airline operations, FSC and LCC;
- Committing to overcome infrastructural, human capacity and other constraints;
- Continuing to liberalize market access and ownership/control rules;
- Establishing an ASEAN regulator to oversee and enforce harmonized standards; and
- Fostering a united ASEAN negotiating stand vis-à-vis other countries and blocs.■

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