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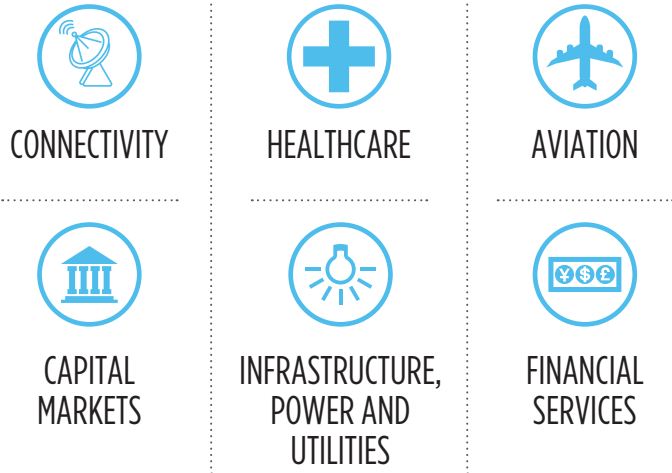


LIFTING-THE-BARRIERS REPORT FOR ASEAN AVIATION

Protectionism is the main barrier for 'ASEAN open skies'

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OVERVIEW



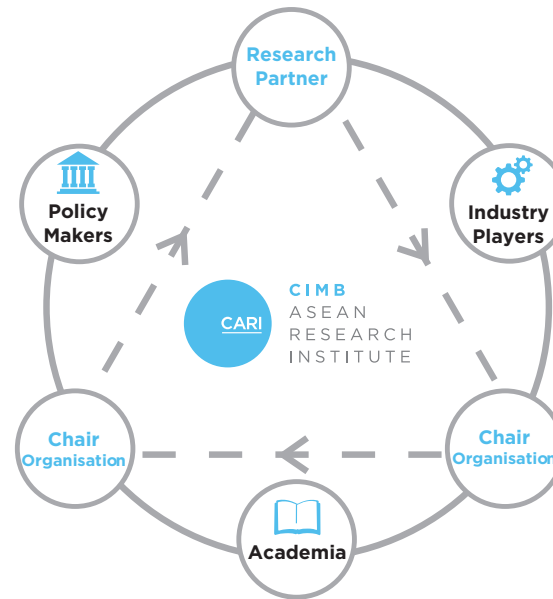
Research objectives:

The CIMB ASEAN Research Institute (CARI) in collaboration with the ASEAN Business Club (ABC) launched the Lifting-The-Barriers (LTB) Initiative in early 2013 as an integrated year long research platform involving core research as well as stakeholder engagement.

The objective was to adopt a vertical approach by means of identifying bottlenecks and barriers hindering free trade of prioritised sectors in the context of the ASEAN Economic Community (AEC).

The LTB Initiative targets six identified sectors which have pressing relevance to the business landscape in ASEAN and will play a major role in the successful formation of the AEC. The six sectors were Connectivity, Healthcare, Aviation, Capital Markets, Financial Services and Infrastructure, Power & Utilities.

RESEARCH STRUCTURE



Two leading **ASEAN corporations** were selected to champion each sector, providing the direction and experiential insight into their industry. The input from these champions, or chair organisations, were key to understanding the issues faced by industry stakeholders and to develop the recommendations as part of the discourse.

CARI's Research Working Committee and its Strategic Advisors also worked closely with each of the six nominated Research Partners in producing these reports.

The Research Partners were either top management consulting firms and academic institutions who provided the technical knowledge and quantitative analysis required.

METHODOLOGY

PHASE I PRELIMINARY RESEARCH
Core research and compilation of qualitative and quantitative input from targeted sectors

PHASE II ABC FORUM
LTB Roundtables + Plenary Sessions

PHASE III LTB REPORTS
The final outcome, a set of white papers, for ASEAN policy makers and community to effect real changes in the region.

Phase I: LTB Preliminary Research

Phase I of the LTB Initiative involves core research and compilation of qualitative and quantitative responses as surveyed from within each of the six business sectors. The outcome of Phase I are the six sector-based Preliminary Papers, intended to provide a base to build discussions on in the next phase.

Phase II: Network ASEAN Forum (NAF) 2013

The NAF was designed to convene six sector based roundtables with the aim of identifying barriers. The NAF served as a platform for different stakeholders to deliberate on relevant issues and to collectively propose viable recommendations to remedy them. Participants of this discussion include regulators, private sector leaders, service providers, manufacturers, academics and many more. The selection of discussants aimed to provide a well rounded and reflective debate.

Phase III: Launch of the LTB Reports

The third and final phase of the LTB Initiative saw the consolidation of all research and discussion materials from Phase I and Phase II. Phase III involved the launch of the final LTB Reports, as a set of white papers presented to the relevant ASEAN policy makers.



PROTECTIONISM IS THE MAIN BARRIER FOR 'ASEAN OPEN SKIES'

By: Centre for International Law (CIL) - National University of Singapore | Published by: CARI, August 2013
Chair: Tony Fernandes, Group CEO, AirAsia Group | Cochair: Emirsyah Satar, CEO, Garuda Indonesia



BACKGROUND

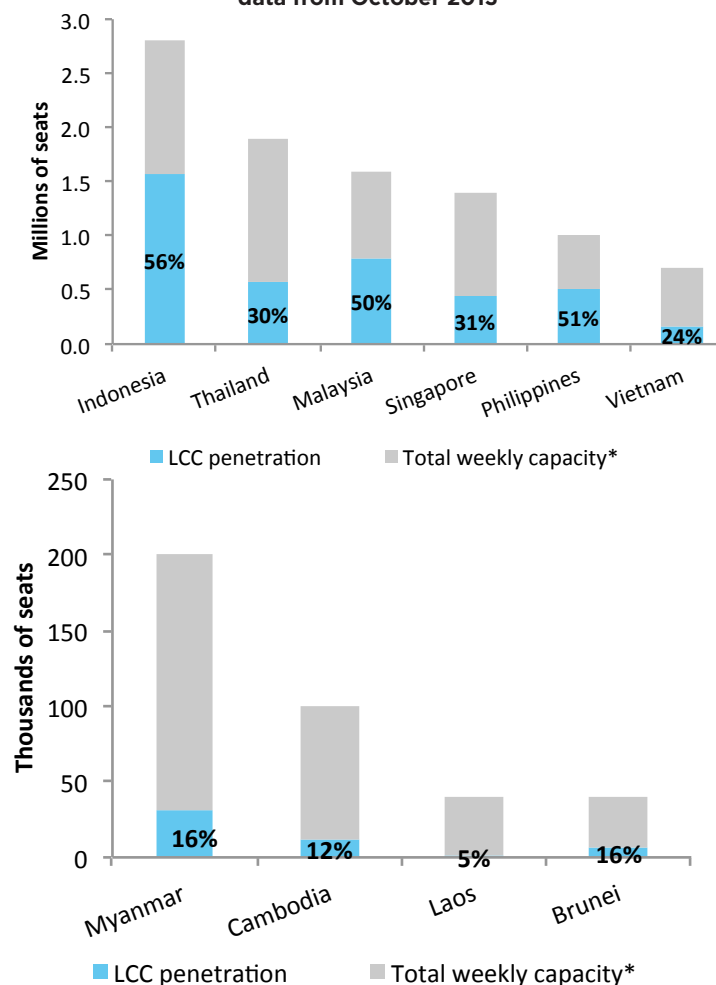
Research objective:

To analyse the issues confronting the aviation sector in ASEAN, including the barriers faced by the ASEAN Single Aviation Market, and to identify strategies to lift these barriers.

Overview: Boom in LCCs

- The aviation landscape in ASEAN is changing rapidly, especially with the advent of the **low-cost carriers (LCCs)**, which now account for more than half of all airline capacity in Indonesia, the Philippines, and Malaysia.
- The **total weekly capacity of all carriers in ASEAN is 9.78 million seats**. The **average LCC penetration rate is 29%** and LCCs' share of capacity is expected to increase even more dramatically in the next decade.
- LCC operations continued to grow through the down period following the financial crisis
 - In 2009, recognised as a hard year for aviation worldwide, LCC passenger traffic and aircraft movements at Singapore Changi airport **increased 50%** over the previous year.
- Six intra-ASEAN routes** are now **among the top ten busiest** international LCC routes in the world.
- Infrastructure build-up** to meet the growing LCC traffic **is lacking** in ASEAN and airports and terminals dedicated to LCC operations remain the exception.
- Many of the main airports in ASEAN capitals have **reached saturation point** or even exceed their intended capacity, **resulting in congestion and delays**.
- The LCC boom exacerbates the congestion problem, especially since LCCs typically use smaller planes with higher frequency of take-off and landings.
- Due to the lacking infrastructure and high congestion, there is a problem with the availability of suitable landing and take-off slots, which has forced some airlines to take-off and arrive at unfavourable hours.
- The growth in the aviation sector also puts pressure on the provision on human capital: the **Asia-Pacific is estimated to require 185,000 more pilots and 243,500 more maintenance personnel for the next 20 years**.

Overall aviation market size (international and domestic) and LCC penetration - data from October 2013



* System wide weekly capacity in millions of seats, all carriers locals and foreign

MULTIPLIER EFFECT OF INFRA-STRUCTURE DEVELOPMENT

- Liberalisation of air passenger and air freight services in ASEAN is set for **2015** with the establishment of an **ASEAN Single Aviation Market (ASAM)** - also referred to as the **“ASEAN Open Skies”** policy.
- ASEAN created an **Action Plan for ASEAN Air Transport Integration and Liberalisation 2005-2015** and an accompanying **Roadmap for Integration of Air Travel Sector (RIATS)** to guide the way to an open sky in ASEAN.
- ASEAN has also adopted three multilateral agreements to formalise the liberalisation of the ASEAN aviation sector:
 - **MAAS** - Multilateral Agreement on Air Services
 - **MAFLPAS** - Multilateral Agreement for the Full Liberalisation of Air Passenger Services
 - **MAFLAFS** - Multilateral Agreement for the Full Liberalisation of Air Freight Services)
- The liberalisation of the ASEAN aviation sector is aimed at two main areas:
 1. **Market access** - the unlimited third, fourth and fifth freedom operations within the region
 2. **Ownership and control** - the easing of the traditional “substantially owned and effectively controlled” requirement
- The multilateral agreements adopted by the ASEAN member states (AMS) were designed to provide **unlimited third, fourth, and fifth freedom operations**.

BENEFITS OF AIR SERVICE LIBERALISATION - WHAT DOES RESEARCH SHOW?

- Numerous comprehensive studies on the benefits of air services liberalisation for ASEAN countries have been made, of which most are unanimous that the overall **benefits of liberalising the aviation industry** include:



Indonesia

- **Research objective:** To quantify benefits for Indonesia in 2025 of an ‘ASEAN Open Skies’ policy.
 - **Estimated size of benefits:**
 - ▶ Additional GDP = 7 trillion Rupiah (US\$679 million)
 - ▶ Additional jobs created = 32,000
 - ▶ Decrease in real air fares = 2.5% per annum
 - ▶ Additional international passenger traffic = 16.3 million per year by 2025
 - ▶ Additional international air freight traffic = 290,000 tonnes per year by 2025
- Source:** Indonesia Infrastructure Initiative (IndII) (2011)

2006 study on Malaysia and Thailand

- **Research objective:** To study the impact of liberalisation (unlimited 3rd and 4th freedom rights) between the two countries in 2005.
 - **Size of benefits:**
 - ▶ No. of passengers travelling between the two countries = 1.5 million
 - ▶ No. of passengers travelling as a result of the liberalised arrangement = 370,000
 - ▶ Additional full-time jobs (per country) = 4,300 (est.)
 - ▶ Additional GDP (per country) = US\$114 million
- Source:** InterVISTAS-ga (2006)

Description of the nine freedoms of the air		
1 st	The right to fly over a foreign country, without landing.	
2 nd	The right to land in a foreign country for non-traffic purposes.	
3 rd	The right to fly from one's own country to another.	
UNLIMITED		
4 th	The right to fly from another country to one's own.	
5 th	The right to put down and to take on traffic in a foreign country coming from or destined to a third country.	
6 th	The right of transporting, via the home country of the carrier, traffic moving between two other countries.	
UNADDRESSED		
7 th	The right to fly between two foreign countries without any stop in home country.	
8 th	The right of transporting traffic between two points in a foreign country on a service which originates or terminates outside of foreign country.	
9 th	The right of transporting traffic in a foreign country on a service performed entirely within the foreign country.	

Source: International Civil Aviation Organization



KEY FINDINGS

- The study finds **four main barriers** to liberalisation:

Barriers	Recommendations
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1. Non-acceptance of ASEAN agreements and protocols by several members

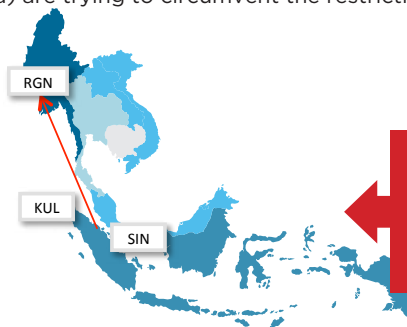
- ASEAN is currently **far from its goal of an ‘open sky’**
 - market access relaxations **do not include the crucial 7th freedom** and domestic carriage operations
 - Indonesia, Laos and the Philippines** have **not even fully accepted the relatively modest 3rd, 4th, and 5th freedom.**
- The main non-contracting party is **Indonesia**, which given its size and influence substantially affects the entire ASAM project.
 - Indonesia’s concern is that **stronger airlines from other ASEAN countries will dominate the international market** between Indonesia and those countries.
 - The **Indonesia National Air Carriers Association (INACA)** also argues that there is a **systemic imbalance** for exchanging traffic rights since Indonesia is a huge archipelago with hundreds of destinations while other AMS have relatively few.
 - The Indonesian government has proposed only five points to include in an ‘ASEAN Open Sky’ – Jakarta, Surabaya, Medan, Makassar and Bali, and the INACA has suggested adopting a partial open skies policies with some ASEAN states while allowing others full access.
- The Philippines** government **has opened access to its secondary cities** while restricted access to its capital Manila, due to the shortage of landing and take-off slots and runway congestion at the city’s main airport.

- ASEAN members, the ASEAN Secretariat, and the region’s airlines **must continue to encourage the Indonesian government and its carriers to accept open skies policies by providing the right incentives** – facilitating Indonesian carriers to grow operations into points in ASEAN, technical assistance, code-sharing, joint-operations, and any kind of cooperation.
- Engage other stakeholders in Indonesia such as provincial governments, tourism, foreign investment and commodity export sectors, to lobby for liberalisation.

2. Non-inclusion of seventh freedom and domestic operations

- As many of the ASEAN countries are not fully comfortable with the more modest 3rd, 4th and 5th freedom relaxations, **prospects are bleak for the relaxation of the 7th freedom and domestic operations (8th and 9th)**, but these rights are crucial in a true single aviation market.
- The **multilateral agreements** that ASEAN has made **do not even address the 7th, 8th and 9th freedoms** since AMS have not achieved consensus on the issue.
- AS AMS do not have the 7th freedom rights of operating flights between two other AMS, some carriers (mainly AirAsia) are trying to circumvent the restrictions by using the fifth freedom right creatively.

- Stopping the liberalisation with the 3rd, 4th and 5th freedom rights will make the ASAM incomplete and ineffective, therefore the **7th and domestic relaxations must be pursued in a gradual manner using the traditional method of state agreements.**
- The flight operation described in the example is scheduled for a formal discussion at the **inter-governmental ASEAN Transport Working Group (ATWG)** and the **ASEAN Air Transport Economic Cooperation Sub-Working Group (ATEC)** as AMS are still undecided whether to authorise such an operation due to its 7th freedom nature.
- Even if the 7th and domestic rights are unattainable at present, allowing such creative use of the 5th freedom would be a significant liberalising move.



A flight from KL has the right to put down and to take on traffic in Singapore before heading to Yangon but because of the geography of the three cities, it is likely that the planeload from KL are bound for Singapore and a fresh planeload will board in Singapore bound for Yangon. The flight would thus become an effective 7th freedom operation..



Barriers

Recommendations

3. Ownership and control restrictions

- In most bilateral air service agreements between individual AMS, airlines designated to enjoy the relevant market access rights must be **“substantially owned and effectively controlled”**.
 - This means that foreign interest shareholding **cannot exceed 49%** and official management must be in the hands of locals. In the **Philippines**, foreign interest can not hold more than **40% of shares**.
- Due to these constraints, airlines striving to operate regionally such as AirAsia have had to **establish local subsidiaries** that are technically separate from the parent carrier and to accept minority ownership in the subsidiaries.
- **All three multilateral agreements under ASAM** provide alternatives to the traditional ownership and control rule:
 - 1. ASEAN community carrier**
 - ▶ Under this framework an airline **can be substantially owned and effectively controlled by aggregate ASEAN interest**.
 - ▶ **Effective regulatory control** remains with designating state.
 - 2. Open ownership**
 - ▶ Under this framework a carrier can have substantial ownership and effective control reposed external to the region as long as it **is incorporated in and has its principal place of business in the designating state**.
 - ▶ **Effective regulatory control** remains with designating state.

- The traditional “substantial ownership and effective control” requirement presents two barriers:
 1. ASEAN nationals **can only establish an airline in another member state** if they are prepared to **accept minority shareholding** using the joint venture model
 2. **ASEAN airlines cannot take over each other or merge across borders**
- The way forward for ASEAN member states is to **accept the ASEAN community carrier fully**.
- As the idea of local carriers to be owned and controlled by foreign interest is politically unacceptable in several AMS, **they should be able to opt out of the framework for their own carriers**, without affecting other AMS that wish to adopt the ASEAN community carrier.
- Such an **“opt-out” provision should eventually be phased out** as it is fundamentally contrary to the vision of an ASAM.
- Another possible compromise would be **to allow majority ownership to be in a community carrier manner while effective economic control would remain with the designating state’s nationals**. Such an approach should however also eventually be phased out.

4. Competitive threat from Non-ASEAN carriers

- The shortcoming of the ASAM can potentially **create disadvantages** for ASEAN carriers’ **competitiveness** against those from outside the region.
- The effect of failing to achieve complete intra-regional liberalisation is clear when the region enters into deals with countries outside ASEAN.
- This was evident following the adoption of the **ASEAN-China Air Transport Agreement (ATA)** in 2010.
 - ▶ As the agreement was concluded before internal liberalisation was achieved in ASEAN, **Singapore, Malaysia, Thailand, Myanmar and Vietnam have unlimited third and fourth freedom rights to points in China** while they still do not have the same access to several ASEAN members.
 - ▶ **ASEAN and China have concluded talks to grant unlimited 5th freedom rights** but the lack of a united stand among the AMS and China’s unwillingness to open up its major cities for 5th freedom operations have resulted in a deal that will likely be commercially insignificant.
 - ▶ There is a **long-term systemic imbalance in the ASEAN-China ATA because** under the agreement ASEAN countries can operate to any point in China from points in their own territory while China can operate any point in China to any point in ASEAN. This is because of the lack of a true single ASEAN aviation Market.

- ASEAN members need **to agree on a common negotiating stand** so that they can **enhance their bargaining position**.
- Along with establishing the 7th freedom rights in ASEAN, the ability to negotiate on a common platform is the largest priority for AMS in dealing with external trading partners.
- After the 7th freedom rights have been established in ASEAN, the ASEAN-China ATA should be revise the to include the 7th freedom right.
- ASEAN should continue to press for 5th freedom rights through the major Chinese cities of Beijing, Shanghai and Guangzhou and AMS must be ready to offer their main cities for exchange with the Chinese.
- ASEAN should be careful to also pursue 5th freedom rights when exchanging unlimited 3rd and 4th freedom rights with Korea, Japan, India and other countries.

CONCLUSION

- Overall, ASEAN aviation sector faces barriers related to 1) **infrastructural constrains**, as well as 2) **policy** and 3) **political restrictions**.
- **Policy barrier: government protectionism for airlines**, largely caused by the huge disparity in the relative sizes and competitiveness of the region's airlines.
- **Competition**: Successful airlines from Malaysia and Singapore are regarded "suspicious" - which perpetuates the instinct for protectionism and a "winners vs. losers mindset, even as competition increases from airlines outside the region.
- The 2015 deadline is approaching and judging by the current state of affairs a true single ASEAN aviation market remains elusive.
- However, it is ASEAN's hope that ASEAN member states will recognise in time that it is in their **collective interest to forge a truly single aviation market and a common negotiating position**.

Summary of recommendations to Lifting-The-Barriers

Barriers	Recommendations
INFRASTRUCTURE	
Infrastructure in ASEAN does not meet the needs of the growing LCC industry and existing infrastructure faces increasing congestion.	Governments should invest in increasing airport capacity, with focus on secondary airports and budget terminals to relieve congestion.
INFRASTRUCTURE - SLOTS	
There is a shortage of landing and take-off slots due to lack of terminal space, runway congestion, or air traffic restrictions.	AMS should explore ways to forge a coordinated response, and use a range of solutions including new technologies and market-based slot allocations.
HUMAN CAPITAL	
Increasing demand in the aviation sector will put pressure on the provision of human capital.	ASEAN should ensure harmonised standards and quality of training, and the demand for aviation professionals should be managed on a regional basis.
ASEAN REGULATOR	
There is a need of a regional body to legislate and enforce harmonised standards of technical matters such as air traffic management, safety, security, to meet the requirements of the International Civil Aviation Organisation (ICAO).	ASEAN should create an ASEAN regulator to oversee technical matters. Eventually such a body could mature into an independent administration with a regional mandate.

Barriers	Recommendations
MARKET ACCESS	
The ASAM project stops with the 3rd, 4th and 5th freedom, which leaves the single aviation market incomplete.	AMS must go beyond the current liberalisation agenda and give each other the 7th freedom and domestic operation rights (8th and 9th freedoms).
NON-ACCEPTANCE OF ASEAN AGREEMENTS	
Several AMS have not yet ratified the protocols that give the 3rd, 4th, and 5th freedom in the ASEAN multilateral agreements. Indonesia, the country with the largest air travel market, is the main non-contracting party.	Provide incentives for Indonesian carriers to support the acceptance of the ASEAN multilateral agreements. Engage other stakeholders, such as the tourism sector, to emphasize the benefits of liberalisation.
OWNERSHIP AND CONTROL	
Airlines in most AMS must be majority-owned by the nationals of the home country.	AMS should accelerate efforts to recognise "community carriers" that can be majority-owned by ASEAN nationals.
EXTERNAL RELATIONS	
Without the right of the 7th freedom, ASEAN carriers are disadvantaged against outside carriers from third states with a unified home market, such as China or the EU.	This network imbalance can only be rectified if the ASEAN member states allow the 7th freedom right.

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