PREPARING ASEAN FOR OPEN SKY

AADCP Regional Economic Policy Support Facility
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Abstract

This Report discusses how the ASEAN countries can move towards Open Sky. Open Sky is a target which has been set for 2015 in *"The Roadmap for the Integration of ASEAN: Competitive Air Services Policy",* prepared by the ASEAN Air Transport Working Group and endorsed by the ASEAN Transport Ministers during the during their 9th Meeting in Myanmar last October 2003. Open Sky will be an important component of the overall economic integration of ASEAN, since transport links are critical to bringing down barriers to trade, and facilitating change.

The objective of this Report is to assist in preparing ASEAN for Open Sky in several ways: *by* providing information about what Open Sky has meant for other regions; *by* outlining the dimensions of Open Sky - the various policy options open to ASEAN countries; *by* indicating how these are likely to work; *by* outlining the benefits and costs which are likely to be associated with these policy options; *by* providing countries with a framework with which they can analyse the probable impacts from individual policy options, and from Open Sky as a whole; *by* indicating possible problem areas, and how they can be addressed; and *by* suggesting ways in which the move to Open Sky can be facilitated.

Recognizing the differences in the levels of economic development and capabilities of the airlines, the study proposes the creation of three sub-regional groupings prior to the ASEAN-wide Open Sky namely: Cambodia-Laos-Myanmar-Vietnam plus Thailand and Brunei (CLMV+T+B), Vietnam-Indonesia-Philippines plus Brunei (VIP+B), and Singapore-Malaysia-Thailand plus Brunei (SMT+B). It expands policy options to be covered by the liberalization process and proposes a timeframe for the implementation of policy packages within the framework set by the Roadmap. Facilitation measures are explored to manage the transition phase given that negotiating moves towards any open skies agreement is normally a difficult process.

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Abbreviations

AAPA	Association of Asia Pacific Airlines
ACAC	African Civil Aviation Conference
AFAS	ASEAN Framework Agreement in Services
AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
AOC	Air Operating Certificate
APEC	Asia-Pacific Economic Co-operation
ASA(s)	Air Service Agreement(s)
ASEAN	Association of South East Asian Nations
ASG	Air Services Group – part of APEC
ASPA	Association of South Pacific Airlines
ATWG	Air Transport Working Group
BIMP-EAGA	Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area
BOT	Build Operate Transport (a device for private sector provision of public infrastructure).
BTCE	Bureau of Transport and Communications Economics, Australia
CARICOM	Caribbean Community
CIQ	Customs, Immigration and Quarantine
CLMV + T + B	Cambodia-Laos-Myanmar-Vietnam + Thailand + Brunei. A proposed sub-regional open sky agreement
CLMV	Cambodia-Laos-Myanmar-Vietnam ‘Open Skies’ agreement
CRS	Computer Reservations System (the carriers system)
EC	European Commission
EO 219	Executive Order 219 (Philippines)
EU	European Union
FDI	Foreign Direct Investment
FEDEX	Federal Express
FIC(s)	Forum Island Country(s)
FSC(s)	Full Service Carrier(s)
GATS	General Agreement on Trade in Services
GDS	Global Distribution System (a multi-host system used by travel agents to book airline seats and to access management systems)
GSA	General Sales Agent
ICAO	International Civil Aviation Organization
IMT-GT	Indonesia-Malaysia-Thailand Growth Triangle
ITC	Inclusive Tour Charter
KLIA	Kuala Lumpur International Airport
LCC(s)	Low Cost Carrier(s)
MALIAT	Multi-Lateral Agreement on the Liberalization of International Air Transportation
MASA	Multi-Lateral Air Service Agreement
MOU	Memorandum of Understanding
NM	Nautical Mile
OECD	Organization for Economic Co-operation and Development
PAL	Philippine Airlines – IATA Designator: PR
PIASA	Pacific Islands Air Services Agreement
PRC	Peoples Republic of China
SAM	Australia New Zealand Single Aviation Market
SMT + B	Singapore-Malaysia-Thailand + Brunei. Proposed sub-regional agreement.

SPA	Special Pro-Rate Agreement
TWG	Transport Working Group
UK	United Kingdom of Great Britain
UPS	United Parcel Service (a corporation)
US	United States of America
US$	United States Dollar
VIP + B	Vietnam Indonesia Philippines + Brunei. Proposed sub-regional agreement
WTO	World Trade Organization
WTO/OMT	World Tourism Organization
"3rd Package"	One of the stages of European Aviation Reform

City Codes – Principal ASEAN Points

BKI	Kota Kinabalu
BKK	Bangkok
BWN	Bandar Seri Begawan
CEB	Cebu
CNX	Chiang Mai
DAV	Davao
DPS	Denpassar
HAN	Hanoi
HKT	Phuket
JKT	Jakarta
KCH	Kuching
KUL	Kuala Lumpur
LPQ	Luang Prabang
MDL	Mandalay
MED	Medan
MNL	Manila
PEN	Penang
PNH	Phnom Penh
REP	Siem Reap
RGN	Yangon
SGN	Ho Chi Min City
SIN	Singapore
SUB	Surabaya
VTE	Vientiane

Carrier Designators

AF	Air France
AI	Air India
6T	Air Mandalay
VN	Air Vietnam
AO	Australian Airlines
PG	Bangkok Airways
J8	Berjaya Air
BG	Biman Bangladesh Airlines
BO	Bouraq Indonesian Airlines
CX	Cathay Pacific
CI	China Airlines
KB	Druk Air
MS	Egypt Air
EK	Emirates
KL	KLM Royal Dutch Airlines
AY	Finnair
GA	Garuda Indonesia
GF	Gulf Air
IC	Indian Airlines
JL	Japan Airlines
VJ	Jataya Airlines
KU	Kuwait Airways
QV	Lao Aviation
JT	Lion Airlines
LH	Lufthansa Airlines
MH	Malaysia Airlines
M8	Mekong Airlines
MZ	Merpati Airlines
8M	Myanmar Airways
OX	Orient Thai Airlines
9Q	PB Air
BL	Pacific Airlines
PR	Philippine Airlines
QF	Qantas Airways
QF	Qatar Airways
BI	Royal Brunei Airlines
RL	Royal Phnom Penh Airways
FT	Siem Reap Airways
MI	Silk Air
SQ	Singapore Airlines
UL	Srilankan Airlines
LX	SWISS
TG	Thai International
TK	Turkish Airlines
VN	Vietnam Airlines
HK	Yangon Airways
IY	Yemenia Yemen Airways

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Acknowledgments

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EXECUTIVE SUMMARY

1. Issues

The meaning of Open Sky in the ASEAN must be determined. For the purposes of this Report, it is taken to refer to a situation of extensive liberalisation within the ASEAN region. It concentrates on the international links between members of ASEAN, and is not so concerned with domestic cabotage. The report does not focus on beyond rights, or on 5th freedom operations of non-ASEAN airlines within the region, though it recognises that these can have an impact on Open Sky arrangements.

The rationale for Open Sky is taken to be to promote competition in the airline industry, and to give all airlines from ASEAN the scope to compete on intra ASEAN routes. Open Sky will also give airlines extra flexibility over their route development.

Issues which need to be considered include: How well Open Sky will work in ASEAN? Will markets be competitive enough? Will there be shifts in hub location? Will anti competitive strategies affect operation? And will there be instability in the industry?

2. Experience of Open Skies Elsewhere

There are many Open Skies bilateral agreements, and a few regional agreements. Few regional Open Skies agreements have led to substantial liberalisation or integration. The exception is Europe - Open Skies in Europe has meant the formation of a single aviation market. Significantly, this arrangement did not come about as a result of countries negotiating an open skies agreement - rather it was imposed on them by a central authority, as a consequence of the Treaty they signed when joining the Community. Open Skies have worked well overall in Europe. There has not been excessive instability, there has been a moderate degree of restructuring, and there has been significantly more competition, especially from the low cost carriers which now have an important share of the market.

3. Policy Background

Within ASEAN, there is a wide range of types of bilateral agreements in place and a range of government policy stances. Some bilateral agreements are very liberal, though others are restrictive, limiting the number of airlines which can compete, and the amount of capacity they can offer. Many countries are now allowing additional gateways, but the impact of this is lessened in some cases because overall capacity is still limited.

Policy stances of the countries vary. Some countries are currently very liberal, placing few limitations on international aviation. Others prefer to see a gradual move towards liberalisation away from present arrangements. Several are prepared to endorse liberalisation on a sub regional basis, such as the planned CLMV open skies agreement. Countries have mixed attitudes towards ownership of airlines- several are moving to a de facto principal place of business criterion. As elsewhere, countries are concerned for how their own airlines will fare under Open Sky.

4. Industry Background

The aviation industry in ASEAN is quite heterogeneous. There are some large airlines, with a fringe of small airlines. Some airlines are world leaders in profitability and productivity. Several of the older flag carriers are experiencing difficulties, partly as a result of the crises which have impacted on them over the past six years. Several carriers from the countries with less experience in aviation are having difficulties in getting established. There is now a small but developing low cost carrier sector, which has been successful so far. Overall, airlines differ widely in their competitiveness and readiness to move to an open market.

5. The Scope for Gains

Ultimately, the gains from Open Sky will come about from greater airline productivity, better targeting of markets, and from improved operational flexibility for the airlines. Opening up routes to competition, and allowing more scope for ASEAN airlines to serve particular routes will drive improvements in productivity. Competition will put pressure on airlines to lower costs, and to pass cost savings on to passengers. Additional flexibility in operations and route development will enable airlines to reduce costs. It is likely that low cost carriers will become more prominent in a liberalised environment. These airlines will provide a stimulus for serving more markets, and they will put pressure on existing airlines to perform well.

6. Policy Options

Moves towards Open Sky will involve taking up a range of individual policy options, each of which will have its own impacts. The policy options apply to combination and pure cargo services.

The most important policy options are:

- Removing investment and ownership controls;
- Permitting multiple designation;
- Removing route capacity controls;
- Relaxing restrictions on gateways; and
- Wet lease aircraft to be allowed within ASEAN.

These are changes, which are likely to have the largest impact on the ways the aviation market works. Other policy options are:

- Relaxing fare restrictions;
- Granting 5th freedom, both within and beyond ASEAN;
- Allowing 7th freedom operations;
- Charter liberalisation;
- Enhancing market competition;
- Cargo liberalisation;
- Allowing domestic cabotage;
- Removing restrictions on ground handling; and removing doing business restrictions.

These options can be implemented on a sub regional basis, or on a whole of ASEAN basis.

7. Stages of Reform

7.1. Sub Regional Initiatives

These are considered first. One suggestion is to build on the emerging CLMV Open Sky arrangements by admitting Thailand, and subsequently Brunei. This is partly based on the importance of Thailand for aviation within the geographic areas. However, granted the relative strength of the Thai airlines, a gradual entry is suggested.

A second subregion could be one based on Vietnam, Indonesia and the Philippines, with the possible addition of Brunei. These countries are at a similar stage of airline industry development.

The third sub region is based on countries which already have strong aviation sectors-Singapore, Malaysia and Thailand, with the possible inclusion of Brunei**.** Many routes amongst these countries are already liberalised.

7.2. Whole of ASEAN Reforms

A staged process of liberalisation for ASEAN as a whole is suggested. Three stages are suggested:

Phase 1- commencing at the beginning of 2005, and continuing till the end of 2007

Phase 2-commencing at the beginning of 2008 and continuing till the end of 2010.

Phase 3- commencing at the beginning of 2011 and continuing till the end of 2012.

These phases allow for the achievement of the Road Map target of Open Sky by 2015, allowing for a degree of flexibility in timing.

7.3. Key Aspects of the Phases

Phase 1- double designation, move to substantial ASEAN ownership; unlimited 3rd and 4th freedom within ASEAN; and opening of secondary gateways.

Phase 2- Multiple designation; restricted 5th freedom beyond rights; completion of opening up of gateways, remove restrictions on fares.

Phase 3 - Principal place of business for ownership; 5th freedom within ASEAN; possible 7th freedom within ASEAN, charter liberalization.

Over the whole period, specific attention will be paid to market competition issues, especially addressing code shares between airlines competing directly on routes. The key aspects apply to both combination and pure cargo services.

8. Impacts, Benefits and Costs

The primary benefits and costs from liberalisation will be experienced by:

- Passengers, who gain from lower fares and better services; and
- Airlines, which lose out from lower fares, but gain to the extent that costs fall, and from access to new markets.

The main secondary benefits come from the economic gains countries make from tourism expenditure. Lower airfares and better services will stimulate inbound tourism and increase expenditure. Outbound tourism will also increase for some countries, and some countries may lose from this effect.

There is a range of other impacts which will create benefits or costs, depending on the circumstances. These include government revenue effects, foreign exchange effects, employment effects, impacts on risks and improvements to business communications within ASEAN.

The ways in which the policy options can impact on the benefits and costs facing country are summarised in a Policy Options/ Objectives Matrix. Impacts do depend on the particular circumstances facing a country- the relative size of inbound and outbound tourism, its airlines' market shares and other factors. Worked examples illustrate how individual countries can gain, and in some cases lose, from the adoption of particular policy options.

8.1. Overall Impacts on ASEAN

Lower fares and better services will mean that as a group, passengers from ASEAN will gain. The impact on airlines depends on how much they are able to improve productivity to match the more competitive fare environment. Some airlines will gain from enhanced market access. To the extent that costs fall, the gains to passengers will outweigh the reductions in profits to airlines.

Lower airfares within the region will mean that the ASEAN region will become more competitive, as a tourist destination. Intra ASEAN tourism will now become more attractive relative to beyond ASEAN tourism for residents. Both these effects will increase tourism in the region, and thus increase tourism expenditures and economic benefits.

9. Problems Areas

With a move to Open Sky, a number of problem areas could emerge. It is possible to address them however:

There is a risk of anti competitive behaviour, such as predatory pricing and collusion. Granted that competition policy is in its infancy in most ASEAN countries, an approach would be to develop an ASEAN code of conduct for airlines.

Subsidies make it difficult for airlines to compete on equal terms. Subsidies may be warranted, but it is important that they be transparent, and allocated on a basis which does not distort competition. ASEAN guidelines could be developed.

The differing business and operating environments make it more difficult for some airlines to compete than for others. Hence a gradual move to Open Sky is recommended.

Financial instability is a problem which currently affects many ASEAN airlines. While there are no easy solutions to this problem, a staged process of liberalisation with time lines will give airlines time to address their financial problems.

Managerial and technical skills availability differs widely amongst the countries of ASEAN. Cross country investments, strategic alliances and cooperation will assist in the reduction of differences.

10. Facilitating the Move to Open Sky

It is recognised that negotiating moves towards open skies is normally a difficult process. Some ways in which change may be facilitated include:

- Linking aviation services with trade of other goods and services at the sub-regional levels will allow countries to exploit the gains from freer movement of manufactured goods, investments and tourism services.
- Building strategic links between tourism industry and agencies, on the one hand, and aviation on the other will give voice to the tourism benefits which will flow from Open Sky.
- Building a better data base in aviation will help, through highlighting problem areas, identifying market opportunities, and enabling evaluation of changes.
- Promoting transparency in the allocation of traffic rights, airport and landing slots between or among carriers as countries move from single to dual to multiple designation policies in order to promote competition.
- Highlighting the consumer/passenger aspects of moving to Open Sky will result in a more balanced evaluation of options at policy levels.
- Exploring the demonstration effect, such as from the impact low cost carriers make on secondary markets, will illustrate the possible gains from more competition.
- Increasing the rigor of discussion of aviation issues, through training programs and workshops will make policy makers more familiar with what to expect from Open Sky.

1. INTRODUCTION: OUTLINE OF THE STUDY

This Report discusses how the ASEAN countries can move towards Open Sky. Open Sky is a target which has been set for 2015 in "The Roadmap for the Integration of ASEAN: Competitive Air Services Policy", prepared by the ASEAN Air Transport Working Group. Open Sky will be an important component of the overall economic integration of ASEAN, since transport links are critical to bringing down barriers to trade, and facilitating change. Air transport is especially important for business communication, which makes trade and investment possible. It also plays a critical role in leisure travel, something which is important given that tourism is likely to be a major stimulus for growth for several of the ASEAN economies. Open Sky can also lead to a more competitive airline industry, which has the potential to be a significant export sector in its own right (it already is for one or two ASEAN countries).

Open Sky is not a new target or initiative in ASEAN. In December 1995, the ASEAN Leaders met in Bangkok during the Fifth Summit and decided to include the development of an Open Sky Policy as an area of cooperation in the Plan of Action for Transport and Communications (1994-1996). During their first meeting in Bali the following year, the ASEAN Transport Ministers (ATM) agreed to pursue cooperation in the Development of a Competitive Air Transport Services Policy which may be a gradual step towards an Open Sky Policy in ASEAN. Such objective has been reaffirmed in the ASEAN Vision 2020 and the Hanoi Plan of Action adopted by the ASEAN Leaders.

Furthermore, the Successor Plan of Action in Transport covering the period 1999-2004 identifies enhanced regulatory and competition policy for the ASEAN civil aviation sector as one of its strategic thrusts. Consistent with earlier declarations, the Plan aims to promote a more competitive environment for air transport services and operations, by way of liberalization initiatives and agreements that may be a gradual step towards an Open Sky Policy in ASEAN. Specifically, it calls for the following: (a) Development of the liberalization policy for air freight services; and (b) Adoption of more liberal and flexible air services arrangements, initially for ASEAN sub-regional groupings like Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA), the Cambodia-Laos-Myanmar-Vietnam (CLMV), etc. In 2001, the ASEAN Transport Ministers at the 7th ATM agreed to launch a regional initiative for the progressive and phased liberalization of air services in ASEAN, by providing greater market access, flexibility and capability in air services operations.

The ASEAN Memorandum of Understanding (MOU) on Air Freight Services signed in September 2002 is a first step towards the full liberalization of air freight services in ASEAN. The ASEAN Leaders are due to sign an ASEAN Tourism Agreement later this year, which among others provide for the facilitation of international travel and intra-ASEAN travel. The ultimate goal of Open Sky would entail a phased and progressive approach to liberalizing (1) Air Freight Services; (2) Non-scheduled Passenger Services; and (3) Scheduled Passenger Services, initially within the ASEAN Growth Areas and between Growth Areas.

During the past two years, the ASEAN Air Transport Working Group developed the "Roadmap for the Integration of ASEAN: Competitive Air Services Policy" - the liberalization steps and indicative implementation periods/timeframes – which was endorsed by the ATM during their 9th Meeting in Myanmar last October 2003. Following from the ASEAN Leaders' directive to accelerate the integration of the air travel and tourism sectors, the Ministers directed their officials to develop a regional action plan for staged and progressive implementation of Open Sky arrangement in ASEAN and to prepare an updated transport cooperation plan for 2005-2010 for the adoption of the 10th ATM.

Achieving Open Sky will not be easy. The experiences of other regions, discussed in Chapter 3 and based on a number of a key references (see Appendix 1), illustrate this. Within individual ASEAN countries, some groups may not gain from Open Sky, and some groups which will turn out to be gainers are nevertheless concerned that they might lose. Adjustment costs will be incurred in the earlier stages, and the gains will be reaped later. It is probable that all ASEAN countries will gain from Open Sky, though some may face costs initially. Open Sky promises significant gain for ASEAN as a whole, and it will be a critical facet of overall economic integration.

The objectives of this Report are to assist in preparing ASEAN for Open Sky in several ways:

- By providing information about what Open Sky has meant for other regions;
- By outlining the dimensions of Open Sky - the various policy options open to ASEAN countries;
- By indicating how these are likely to work;
- By outlining the benefits and costs which are likely to be associated with these policy options;
- By providing countries with a framework with which they can analyse the probable impacts from individual policy options, and from Open Sky as a whole;
- By indicating possible problem areas, and how they can be addressed; and
- By suggesting ways in which the move to Open Sky can be facilitated.

A central part of the Report suggests a program of phases of implementation of Open Sky. This will lead to a gradual opening up of air transport markets in the region. The objective is to achieve Open Sky shortly before the target in the Roadmap, to allow some flexibility in timing.

The phased program has been developed with several factors in mind including the Roadmap for the Integration of ASEAN: Competitive Air Services Policy. Given the nature of current industry and government policies, time needs to be allowed for adjustment. Several changes should be relatively easy to achieve, and can enable some of the benefits to be gained early on. These changes, when implemented, will lead on to further change. Under the suggested phased program, airlines which are only now becoming established, or which are undergoing a period of restructuring after the crises of the past few years, will be given time to adapt and prepare for more competition. While change needs to be gradual, it does need to be real, and airlines will need to become more exposed to competition. If they are continually protected from competition until they are ready, they will never be ready.

A key objective of this Report is to provide a stimulus for discussion. The move towards Open Sky will require negotiation amongst countries, and these countries will wish to be well informed about issues and consequences. The Report seeks to provide information, and to suggest possible courses of action. It also indicates how these can be assessed, from the perspective of individual countries and from ASEAN as a whole.

The meaning of Open Sky, and some of the issues associated with its implementation, are discussed in Chapter 2. A literature review is provided in Chapter 3 – the primary focus is on the experiences of other regions which have initiated moves to open skies. Chapter 4 consists of a review of the airline industry in ASEAN, and of air transport policies. The scope for gains from Open Sky is considered in Chapter 5. Chapter 6 constitutes the core of the Report - the individual policy options which make up Open Sky are outlined and analysed, and a three phase package of reforms, to move to Open Sky, is suggested. These phases allow for different speeds of adjustment amongst the sub regions. In Chapter 7, a framework for determining how the policy options and Open Sky generally can lead to benefits and costs to the individual countries is outlined. The possible benefits and costs for ASEAN as a whole are considered in Chapter 8. Possible problem areas, with some suggestions on how they can be addressed, are discussed in Chapter 9. Various institutional and other ways in which the moves to Open Sky can be facilitated are suggested in Chapter 10. Finally, some suggestions for follow up work are identified in Chapter 11.

2. ISSUES IN MOVING TO OPEN SKIES

Open Skies air transport agreements are considered to bring distinct economic benefits to participating countries. However, they are notoriously difficult to achieve, especially between groups of more than two countries with different levels of economic development and airline capabilities as in the case of ASEAN. The Roadmap For Integration of ASEAN: Competitive Air Services Policy prepared by the Air Transport Working Group recognizes such disparities. It proposes to remove restrictions on 3rd, 4th, and 5th freedom traffic rights on a gradual or progressive basis (see Appendix 2). A rapid, comprehensive move towards Open Skies is very unlikely, though carefully staged moves may be possible.

This section aims to explore the various issues associated with opening up the ASEAN air transport markets among member countries. This study likewise aims to determine if there are packages (or stages) which the countries as a group could agree to and where the scope of liberalization can go beyond mere exchange of traffic rights. To this end, it is necessary to:

- Determine what Open Skies might consist of;
- Consider the rationale for Open Skies, and what problems might emerge with it;
- Examine how packages of reforms might actually work; and
- Evaluate the impacts of different packages on member countries, in an effort to design packages which might be broadly acceptable.

2.1 Definition of Open Skies

The term “Open Skies” poses a number of questions which need to be resolved for the current study. The issues are definitional, geographic and functional.

Open Skies is not a single, well-defined concept. Rather, it refers to packages of a number of distinct policy aspects, such as capacity deregulation and removal of price controls, which lead to less regulated airline services. It is a strategy of opening up aviation markets, which can be pursued on a bilateral, regional or multilateral basis. In particular, Open Skies gives rise to:

- More competition between airlines;
- More scope for airlines of a third country to serve on a route between two other countries; and
- More flexibility for airlines to develop their routes and networks as they choose.

As noted, there is a range of policy components or aspects which may or may not be present in a specific Open Skies package. For example, an agreement may permit any airline from two countries to serve routes between them, but it may not permit airlines from other countries. In Section 6 of this report a list of individual policy options is provided which can all be part of an Open Skies package.

For the present study, a major task is to determine which combinations of policies can be included in packages that will be relevant in the ASEAN context.

Another dimension of Open Skies is the geographic one. Over which routes should Open Skies apply? One possibility is to have internal Open Skies, which is the case in the European region. The question then arises of whether Open Skies should or should not apply to purely domestic routes, or only to routes between the sovereign countries of ASEAN?

External Open Skies is also a possibility. This would involve Open Skies between ASEAN and other, consenting, countries. *However, this issue is beyond the scope of this study.*

Yet a further dimension, posing issues that need to be settled, is the functional one. Is Open Skies to apply to all traffic, or to specific market segments? Movement towards Open Skies for air freight is usually less contentious than Open Skies for passenger traffic. A movement to Open Skies may be partial, with some markets being opened up and others not. For example, it may make sense to open up certain markets, such as the leisure market, while continuing to regulate business markets. This has been done in other regions through the creation of effectively Open Skies for charter operations, but with regulation of scheduled carriers. Would this be a possible stage for ASEAN, and would it work effectively?

2.2 The Rationale for Open Skies

The primary rationale for Open Skies is economic. Open Skies, when implemented effectively and when it works as intended, will produce net economic benefits *overall* for the countries participating in the agreement. The problem is that not all individual participants may gain, and hence they will not be willing to enter such agreements.

These overall gains will be created through several processes:

- Competition will push fares down and impose pressure on airlines to keep their costs as low as feasible;
- Openness to trade will mean that the airlines best suited to serve particular markets, regardless of their home country, will be able to serve them, and if competition is strong they will be forced to pass the gains on to travellers. (Trade produces gains from specialisation and from the reliance on comparative advantage); and
- The flexibility of operation under Open Skies will mean that airlines will be able to design networks to maximise efficiency.

Assuming an Open Skies agreement works as intended, it will produce efficiency gains, meaning that the benefits to the gainers will outweigh the costs to the losers. Typically, travellers will gain. Some of these will be from the home country, and thus there will be a benefit to the home country. Where foreign travellers gain, the home country can gain to the extent that tourism to it becomes more attractive, and if additional tourism is regarded as creating economic benefits, liberalisation will lead to greater benefits from tourism.

The almost inevitable problem is that there will be losers. Greater competition and exposure to trade will put pressure on producers, especially airlines and their workforces. Profitability may fall, and the operating environment will become more risky. Some airlines may fail, and if this occurs, some of the cost will be borne by their workforces. Even where the employees retain their jobs, they may be forced to accept lower wages and inferior conditions.

The fact that Open Skies brings losers means that agreement are usually difficult to conclude, especially amongst groups of diverse nations unless they are like-minded in the belief that more open markets will serve consumers better and allow airlines to become more efficient.

Difficulties can arise at three levels:

1. For individual countries, Open Skies may yield lower net economic benefits as compared to the present, more regulated environment;
2. For individual countries, even when they are net gainers from Open Skies, there will be significant groups, such as a long established yet inefficient national airline, that

lose from such a move, and hence those countries may be reluctant to make the move to Open Skies; and

3. Even when individual countries see themselves as gainers from Open Skies in *economic* terms, they have non economic objectives, such as defence and security, which they may see as adversely affected by Open Skies and consequently they may be unwilling to make the move.

In the light of this, there are several questions which will need to be explored in the context of the current study:

- What are the economic and non economic policy preferences of individual countries?;
- What policy constraints do they face?;
- How will particular policy options which form part of Open Skies impact on individual countries? and
- Can packages or stages be designed which minimise the negative impacts and thereby increase the likelihood of agreement and meet the needs of all participants?

2.3 How Well Might Open Skies Work?

For this study, it will be necessary to explore in some detail how Open Skies might actually work, and what benefits and costs it might actually give rise to. Open Skies may not necessarily work exactly as theory predicts, and this is the reason why some nations are reluctant to embrace it as a policy stance. There are risks that need to be recognised and addressed. It is desirable to do this for individual policy components, such as capacity deregulation or pricing liberalisation. Examples of questions which may arise are as follows:

- How competitive will routes be after liberalisation? Will some be dominated by a few airlines, or perhaps only one?
- How will networks and hubs change, and will this lead to loss of services for some countries?
- Will higher cost airlines be able to compete by reducing their costs rapidly?
- Will the less experienced airlines lose out to the more experienced airlines?
- Will foreign airlines be able to develop tourism traffic for the country and therefore generate the desired economic gains from tourism?

The objective is to be aware of the downsides of Open Skies, so that these problems can be addressed.

2.4 Pathways to Agreements on Open Skies

A movement to Open Skies poses an essential policy dilemma. While Open Skies is very likely to lead to economic benefits for the ASEAN countries as a group, some countries may lose out, and others may perceive that they will lose out. These countries' acquiescence will be needed if progress is to be made towards Open Skies. However, since they will lose out, their agreement is not likely.

A key aspect of this study is to examine if there are ways around this policy dilemma. There are no obvious easy fixes. It may be possible, however, to make some progress, and some major positive steps may be feasible. A critical role of this study is to provide information about possibilities for negotiators. It will aim to do this in several ways, by examining:

- Countries' policy preferences, to see what trade offs they might be prepared to make. This will give them the opportunity to consider options and review their trade offs;

- The individual policy options which make up Open Skies packages, to see if there are some which might be more generally accepted than others. Substantial progress may be feasible with limited agreements which do not seek to be all encompassing;
- The likely benefits and costs from individual policy measures, from the perspective of individual countries, and groups within countries. This will mean that member governments will be better informed about what Open Skies may mean for them;
- If there are any policy options which give rise to large gains, but which do not impose any significant costs on any one country then packages based on these options are more likely to achieve agreement;
- Cases where some countries lose - to determine whether there are any modifications that can be made to the policies to lessen or eliminate these costs, while preserving the main sources of gain to other countries;
- Whether there are any packages of policy options or components which cancel out the losses to individual countries so all countries can agree; and
- Whether there are problem areas which may arise in the implementation process and whether there are any measures that can facilitate changes in order to minimize the costs of liberalisation.
- Whether there are any ways of facilitating moves to Open Skies through improving the information base, upgrading needed skills and providing frameworks with which countries can assess the impacts on them of any changes.

The next Chapter will discuss the various experiences of countries in concluding and implementing Open Skies arrangements and in addressing the definitional, geographic and functional dimensions of the move towards Open Skies on a bilateral, regional and multilateral basis.

3. LITERATURE REVIEW AND ASSESSMENT OF OPEN SKIES INITIATIVES

This literature review is intended to draw attention to key issues, rather than provide a detailed evaluation of this literature. The Consultant has identified a number of key references, as well as other references that summarise the issues. The chapter sets out to provide a guide for further reading and indicate the literature we shall draw upon in the rest of the report. This review has been arranged into a number of topic areas - all of direct relevance to the study. We note that the literature on some of topics is much more extensive than on others.

3.1 Overview

3.1.1. History and Policy Development in ASEAN Air Transport

There is a moderate literature on air transport development in the ASEAN countries. A good brief summary is to be found in Oum and Yu (2000). ASEAN air transport features prominently in studies of Asia Pacific air transport, such as Findlay, Chia Lin Sien and Singh (1997) and Hufbauer and Findlay (1996). The journal literature contains a few references to ASEAN, for example Li (1998).

Policy development in ASEAN air transport is best documented in official statements. Broad policy statements, such as the Hanoi Plan of Action (ASEAN, 1998), refer to air transport, and are followed up by more specific policy statements. The key policy issues for air transport, and the main directions for aviation policy are outlined in the ASEAN Transport Cooperation Framework Plan (1999). Specific attention has now been paid to issues such as air freight (ASEAN Memorandum of Understanding on Air Freight Services, 2002). However, there has not been extensive policy development at this stage on passenger services.

3.1.2. Economic and Policy Analysis of ASEAN Air Transport

There have been a limited number of studies which have examined and critiqued economic and policy issues relevant to ASEAN air transport. A study by Findlay and Forsyth (1990) analyses the policy problems facing the ASEAN countries, paying particular attention to the problems arising as a result of the differing competitiveness of the ASEAN airlines (some of these airlines were highly cost competitive, though not all were). A literature review of air transport in the Asian Pacific region, including ASEAN, is to be found in Findlay and Forsyth (1992). Analyses of the policy stance of individual ASEAN members are found in Hufbauer and Findlay (1996). The problems of moving towards liberalisation, in the broader Asia Pacific region, are discussed by Oum (1997) and Tretheway (1997). Further, a recent study by Oum and Yu (2000) pays particular attention to issues which are of major concern in the ASEAN region as well as the broader Asia Pacific. These issues include problems of hubs and infrastructure, the role of strategic alliances and the consequences of liberalisation.

3.1.3. Regional Open Skies

A number of regions have moved towards various forms of regional Open Skies aviation markets. The most significant of these is Europe. European liberalisation (see below) has been a staged process, leading to a substantially deregulated internal market. The focus has been primarily internal, and the member countries still operate their own air transport policies with respect to non-member countries. The European experience is of particular relevance to ASEAN because it involved a significant number of different countries with differing policy preferences. The workings of European liberalisation have been analysed in some detail, and three useful surveys are those by the Civil Aviation Authority (1998) by Button, Haynes and Stough (1998) and by Button and Stough (2000). Specific issues which have become important, such as the emergence of low cost carriers, have also been given considerable attention - see Lawton (2002) and Williams (2002). The journal literature also contains analytical studies of aspects of European liberalisation, notably studies of the competitive dynamics of city pair markets (e.g. Marin, 1995).

Other regional liberalisations have been less extensive, at least in terms of the countries involved, and have attracted less analysis. Whilst the US and Canada have formed a regional market (see below and Tretheway, 1997), the problems of carriers have dominated discussion of air transport in these countries, and there has been little by way of specific evaluation of the workings of regional liberalisation. It is possible that competition from US carriers has been a factor in the financial difficulties which Canadian Airlines International and now Air Canada have faced, but this would have been only one of several contributing factors.

Australia and New Zealand have formed a single aviation market, which came into being in the 1990s. This meant that airlines from both countries could operate with and between the two countries unhindered, though restrictions on beyond rights still remain. The workings of this market have been considered in Findlay and Kissling (1997) and by the Productivity Commission (1998). In general, airlines have not made full use of the rights which are available - for example, New Zealand airlines have not made use of domestic cabotage in Australia.

The papers of the ICAO Liberalisation Conference (2003) contain a useful discussion of the Latin American experiences in regional liberalisation, along with discussion of the West African experience relating to the Yamoussoukro Decision on liberalisation of air transport markets (see below).

3.1.4. Economic Evaluations of Liberalisation

A number of studies have developed methodologies for evaluating the economic effects of liberalisation of air transport. These include ex ante studies, which have projected the effects of planned liberalisation, and ex post studies which have assessed the costs and benefits after liberalisation has taken place. Such studies analyse how competition will work in newly liberalised markets, determine what effects on prices, schedules and costs this competition will have, and translate these into estimates of costs and benefits. The initial studies were of the US after domestic deregulation, some of which adopted an explicit cost benefit framework. A notable study is that by Morrison and Winston (1986).

There have been a number of studies seeking to measure the benefits and costs of proposed international policy liberalisations. An early study, by the Department of Transport and Communications (Australia) (1988), set out a framework of costs and benefits which might come about as a result of various aspects of liberalisation, such as multiple designation of airlines or relaxing capacity controls. Benefits and costs accruing to several stakeholders - consumers, airlines, government and tourist operators - were identified. Similarly, Australia's Bureau of Transport and Communication Economics undertook a detailed economic evaluation of the proposed single aviation market with New Zealand (BTCE, 1991). Since these early studies, more sophisticated methodologies have been adopted, with particular attention paid to modelling the competitive process under conditions where small numbers of airlines compete. Canadian moves towards Open Skies were modelled by Gillen et al (1996), and the impacts of liberalisation of a number of Australia's routes with Asian countries (including some ASEAN members) were assessed by the Productivity Commission (1998) and by Gregan and Johnson (1999). The costs and benefits of implementing Open Skies for Northern Germany are estimated in Gillen et al (2001). A recent study examining the impacts on competition, as well as the costs and benefits which flow from permitting an alliance between the Australian airline Qantas and Air New Zealand, is contained in the New Zealand Commerce Commission (2003) report on the proposed alliance.

These studies have developed a rigorous methodology for evaluating the economic costs and benefits from moves to Open Skies. They have identified the data required and sketched the way in which competition in liberalised markets may work out. They have developed measures of benefits and costs, identified gainers and losers, and indicated the sensitivity to assumptions. Given time and resource limitations, the present study cannot go as far as these studies. However, past studies provide a useful framework for analysis.

3.1.5. Experience with Open Skies

We have identified an extensive literature relating to Open Skies. A detailed discussion of this topic is to be found at 3.2 below. A useful textbook review of the movement towards Open Skies is contained in Chapter 2 of Doganis (2001). A review of the literature relating to competitive behaviour and the gains from liberalisation is found in Forsyth (1998). A recent discussion of Open Skies, and of the interaction between Open Skies regimes and airline strategic alliances, from a US perspective, is given in Stober (2003).

There are a number of references on future directions for air transport policy, especially at the individual country level. The most comprehensive and up to date source on current and future policy is contained in the Proceedings of the recent ICAO Conference (ICAO, 2003). While this conference did not recommend much by way of specific policies, it provided a platform for the exposure of the differing policy positions of countries around the world, and it illustrated the difficulties in reaching consensus positions. A useful, relatively brief statement of future policy options, as well as a discussion of problem areas, such as predatory pricing, will be found in a recent OECD Report (OECD, 1997). Other possible developments of relevance, notably a Trans-Atlantic Open Skies Agreement, are canvassed in Chapter 3 of Doganis (2001).

3.1.6. ASEAN Cooperation in the Transport Sector in General

In general, ASEAN co-operation has focused on[1]:

- The enhancement of ASEAN regionalism through the promotion of wider ASEAN co-operation;
- The pursuit of Regional Economic Integration through harmonization of trade and economic practices; and
- The enhancement of ASEAN competitiveness through the provision of 'basic support to private sectors and the community in the adjustment process to adapt to the changing environment in the global community'.

According to the ASEAN Secretariat, co-operative activities in 2003 are geared toward achieving greater and deeper regional integration. Systematic efforts to remove tariff and non-tariff barriers are being implemented. A major challenge is to identify the areas in which action is required on an ASEAN-wide basis. To assist this process, ASEAN co-operative activities are broken down into 13 sectors. Transport is one of these sectors.

The transport action agenda adopted in the Hanoi Plan of Action, 1998 (and the Successor Plan of Action in Transport 1999-2004) called for:

- Progressive liberalisation of trade in services, notably through the adoption of alternative approaches to liberalisation;
- Development of the trans-ASEAN transportation network, focusing not only on civil aviation but on major road and rail corridors, principal ports and sea lanes for maritime traffic, as well as inland waterway transportation. We note that the pan-

[1] Based on a review of ASEAN cooperation agreements

ASEAN transport network plan has been completed, encompassing 28 major highways, 6 identified rail lines, 46 designated seaports and 51 designated airports.

- Implementation of the ASEAN Framework Agreement on Multimodal Transport; and
- Adoption of harmonised vehicle standards and regulations.

Thus, the policy studies aimed at liberalisation of the airline sector, including the ASEAN Open Sky initiative, have parallels in the land and maritime transport sectors.

So far as road transport is concerned, ASEAN countries have undertaken Project Preparation Studies for the ASEAN Highway Network and Inland Freight Terminal Development. Considerable progress has been made on the ASEAN agreements on multimodal transport and the ASEAN Agreement on the Facilitation of Goods in Transit. Progress has also been made in the adoption and implementation of harmonised vehicle standards and regulations.

In the rail sector, ASEAN leaders have endorsed the broad thrust of the feasibility study on the Singapore-Kunming (PRC) rail project. The line has been given priority project status. ASEAN leaders have endorsed the routes agreed to by the transport ministers.

In the maritime sector, individual ASEAN countries have submitted their offers relating to maritime transport liberalisation. These offers were incorporated into the Third Package of Commitments under the ASEAN Framework Agreement on Services (2001). An ASEAN Cruise Development Study has been completed and an ASEAN Maritime Transport Sector Development Study has been commissioned. At the operational level, training programs for vessel masters and chief engineers have been held and pilot courses in port management and infrastructure management developed.

3.2. Open Skies Aviation Initiatives

3.2.1. Features of Open Skies Agreements

In general, Open Skies Agreements set more liberal ground rules for international aviation than was the norm under earlier Air Service Agreements (ASAs). The phrase refers to a variety of types of pro-competitive airline agreement but does not have a precise, tightly-defined meaning. One effect of the spread of Open Skies Agreements has been to reduce the extent of government intervention in aviation markets. Such agreements may relate to passenger, cargo or passenger-cargo markets. Further, they may relate to scheduled and/or charter services. Open Skies Agreements usually contain some or all of the following provisions:

1. Open Markets: Open Skies Agreements are usually characterized by the abandonment (wholly or partially) of restrictions relating to routes, number of designated airlines, capacity, frequencies and types of aircraft that may be operated;
2. ‘Level Playing Field’: Open Skies Agreements typically include provisions that enable airlines domiciled in countries that are parties to the agreement to compete on a fair and equal basis. For example, carriers may be free to establish sales offices in countries that are signatories to the agreement. Similarly, carriers may be allowed to provide their own ground handling services and/or choose among competing suppliers of ground handling services. User charges are typically non-discriminatory and based on cost;
3. Pricing: Open Skies Agreements typically allow carriers much greater pricing flexibility than the more traditional Air Service Agreements (ASAs) they replace. Usually, a fare can be disallowed only if both governments concur (‘double-disapproval’ pricing) and then only if certain conditions are met;

4. Co-operative Marketing Arrangements: typically carriers are allowed to enter into code-sharing and/or leasing arrangements with airlines of countries which are parties to the agreement;
5. Dispute Resolution: Open Skies Agreements typically include procedures for resolving differences that may arise during the currency of the agreement;
6. Charter Market: Open Skies Agreements typically include provisions freeing-up the charter market;
7. Safety and Security: the governments of contracting states typically agree to observe agreed standards of aviation safety and security.
8. Optional 7th Freedom Cargo Rights: some Open Skies Agreements allow airlines of a member country to operate pure cargo services between another member country and a third country, without insisting on a stop in the cargo carriers home country.

Open Skies Agreements may be multilateral, regional or bilateral.

3.2.2. Multilateral Open Skies Initiatives

Countries have found it difficult to commit to liberalisation on a global basis. The World Trade Organisation General Agreement on Trade in Services (WTO-GATS) for the Air Transport sector excludes any provisions for the liberalisation of traffic rights. Instead, with the exception of the MALIAT Agreement (see below) countries have pursued liberalisation on a regional or bilateral basis.

<u>Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT)</u>
The MALIAT Agreement between Brunei Darussalam, Chile, New Zealand, Singapore and the US entered into force in December 2001. Peru and Samoa have since joined MALIAT. The key features of the Agreement are:

- Open routes;
- Open traffic rights, including 7th freedom cargo services;
- Open capacity (i.e. no capacity limits);
- Airline investment provisions that focus on effective control and principal place of business, but protect against flag of convenience carriers;
- Multiple airline designation;
- Code sharing provisions allow for third country airlines to participate; and
- A minimal tariff filing regime.

MALIAT offers three potential benefits:

- A competition-enhancing model for future agreements: MALIAT mirrors the successful US Open Skies bilateral agreements, which permit unrestricted international air service between the US and its bilateral partners. In expanding the bilateral Open Skies model to the multilateral level, the agreement lays out a future agenda;
- Expanded carrier access to equity financing: most bilateral agreements require local ownership of each country's carriers. Such a requirement makes it difficult for carriers to obtain cross-border financing. The MALIAT Agreement liberalizes ownership requirements, thus enhancing carrier access to foreign funding;
- Streamlining international aviation relations: international aviation is currently governed by thousands of individually negotiated bilateral agreements. The transaction costs incurred in negotiating, monitoring and enforcing these agreements are very high. Multilateral agreements such as MALIAT offer an opportunity to lower transaction costs.

Airline services between the parties to the MALIAT Agreement are limited and the Agreement covers only a miniscule proportion of world aviation traffic. However, in so far as the

Agreement is open to accession by any state that is party to certain aviation security conventions[2], MALIAT provides a model of Open Regionalism in the aviation sector.

The MALIAT Agreement is of interest not only because its members include two ASEAN countries but because its provisions offer an insight into the nature of a liberalized international aviation sector.

3.2.3. Regional Open Skies Initiatives

Regional initiatives have flourished in the past decade as a means of expanding the liberalization process. Most attention is given here to the European and Pacific Islands initiatives, though other initiatives are also discussed.

<u>European Open Skies</u>

The most comprehensive move towards open skies in a region has been achieved in Europe. A substantial liberalisation was achieved about ten years ago, and there has been adequate time to assess the results. The European experience is of direct relevance for ASEAN region, though the results from it cannot necessarily be applied to the ASEAN case.

Background

Prior to liberalisation, Europe generally had a restrictive air transport policy. This policy was encapsulated in the bilateral ASAs between the individual countries. Under these agreements, there was limited scope for competition on most routes, and these routes were dominated by the designated scheduled airlines.

There was an important exception to this general rule - the charter market. In several countries, especially the UK and Germany, there was a large charter airline industry, oriented to carrying passengers from the home country to holiday destinations, particularly those in Southern Europe. These airlines operated on a low cost, no frills basis, and they were designed to appeal to holiday travellers. The packages they offered were quite restrictive: for example, they would offer a full holiday package, not just the airfare. Later on, the products they offered became less restrictive. The effect of these restrictions, along with restrictions on the routes they served, meant that they did not compete directly with the scheduled airlines. They did provide some indirect competition, and on some routes they had an impact on the fares the scheduled airlines were able to charge.

In the main scheduled airline sector, airfares were generally high: fares were higher than in other large markets such as that of the domestic US market, and airline productivity was lower.

The Decision to Liberalise

The European case provides a rare example of substantial liberalisation within a geographic region (there are examples of open skies agreements between non contiguous countries).

European open skies was not the result of countries coming together to negotiate an air transport agreement. Rather, it was the somewhat unintended outcome of a more general process of economic integration. The countries of the European Union had signed the Treaty of Rome, which includes general requirements about competition and opening up markets within the region- it does not specify airline liberalisation specifically. The EU also has a strong central regional authority, the European Commission, along with the Council of

[2] Notably the *Convention on Offences and Certain Other Acts Committed on Board Aircraft (Tokyo, 1963), Convention for the Suppression of Unlawful Seizure of Aircraft* (The Hague, 1070), *Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation* (Montreal, 1971), and the *Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation* (Montreal, 1988).See http://.www.maliat.govt.nz

Ministers. While individual countries in the Union had differing attitudes to open skies (most opposed it), the Commission favoured it. In 1986, the European Court of Justice ruled that competition policy was applicable to the airline industry.

The packages of measures which were implemented were not necessarily those which the individual countries would have agreed to during a negotiating process. There were some pressures for liberalisation- for example, several countries had signed liberal ASAs with other countries, such as the US, and were generally well predisposed towards liberalisation. Open Skies took place in Europe as part of a very extensive liberalisation of markets in the region. The EC recognised that complete liberalisation would not work well if imposed immediately. Rather it recognised that a staged process would be best. It also recognised that some exceptions would need to be granted- for special services for a period, and for some anti competitive practices for a period.

The Liberalisation Process

The process adopted consisted of three main stages, but there were some sub stages, and exceptions.

The first stage began in December 1987. This took the form of some liberalisation of fare setting, along with a freeing up of capacity controls and some additional market access.

The June 1990 package included further relaxation of capacity and fare controls, and it introduced multiple designation.

The final stage was achieved in January 1993, and this brought very substantial liberalisation to air transport markets within Europe. It essentially created a single market. It brought in open market access, and 5^{th}, 7^{th} freedoms and cabotage, for airlines which were majority owned within the EU. Thus an Irish owned carrier operating out of the UK could offer services between Germany and Italy. The regulatory distinction between charter and scheduled operations was removed. Mergers and alliances which would have the effect of monopolising routes were made more difficult. Measures to open up ground handling and access to airports were also introduced.

Airline Competition

European aviation has been extensively liberalised for a decade now. In the early days, there were no dramatic changes. There was some additional competition on individual routes, mainly the high density ones. During the first five years there was good productivity growth, though it was not spectacular. There was not much change in flexible fares, and there were some increases in the higher fares. Some lower fares were offered, but significantly, many more seats at lower fares were made available. There was not much change in the structure of the airline industry- initially, consolidation had been expected. There were a few mergers and some new alliances were established, but there was no shakeout. Some of the new alliances had stringent conditions put on them, since they had the potential to be anti competitive.

The big changes came with the development of the Low Cost Carriers (LCCs). Some of these began earlier, but it was not until about five years ago that they began to have much of an impact. Some of these have now become quite large airlines, with market capitalisation greater than those of the established flag carriers. They continue to grow fast. Now that they have extensive networks, they are beginning to have an impact on the incumbents. They offer low fares (sometimes very low fares) and the incumbents have been forced to respond. Sometimes this has taken the form of offering comparably low fares on a restricted basis. In a few cases, the incumbent airlines have established LCCs of their own. This strategy does not seem to have been very successful, and the LCC subsidiaries have been sold off. The major carriers are concerned about competition from the LCCs, and they have had difficulties in devising strategies to combat them. Competition from LCCs is a factor in the poor profitability of the incumbent carriers, though they are not the sole cause.

The impacts of the LCCs have been selective, since they have not been covering the whole of the European market. To date, the strongest carriers have been those based in the UK, and latterly, Germany. They are now a competitive force in more than half the market, and their networks are expanding. A single LCC can make a considerable difference to fares, especially at the lower end of the range. Thus airline competition does not need to be characterised by large numbers of carriers for it to be working.

Problems and Solutions

A number of problems have emerged as the Open Skies in Europe have developed. These have been addressed, and they have not put the success of Open Skies in jeopardy:

Predatory Behaviour: There have been a large number of cases in which the LCCs have claimed that the major carriers have been competing unfairly against them, by adopting predatory tactics, such as reducing prices below cost. Thus far, predatory behaviour does not seem to have been much of a problem. Some cases of such behaviour have been established, and remedies have been put in place (e.g. major carriers have been constrained from undercutting their rivals for a period). Predation is difficult to prove, and successful convictions for it are rare in the airline industry. Nevertheless the threat of action by competition authorities may be sufficient to deter predatory behaviour. In general, competition authorities in Europe are quite strong, and the European Commission is quite pro active.

Subsidies: In the past, some European airlines have received very large subsidies from their governments (often their owners) when they have encountered financial difficulties. It was recognised early on that subsidies from governments would distort the competitive process. Over time, this has become less of a problem in Europe. Many of the main flag carriers have been privatised in the last decade- while private ownership does not preclude obtaining subsidies, governments are less likely to subsidise airlines which they do not own, and they are more likely to expect that such airlines survive without assistance from them. A number of restrictions have been introduced to prevent subsidisation, and the Commission been vigilant in detecting and addressing cases of subsidy. Long established airlines such as Sabena have been allowed to fail, indicating the seriousness with which the anti subsidy policy is being implemented.

Subsidies do not always go to the flag carriers and the state owned airlines. The LCCs have been adept at negotiating very favourable deals from airports they serve- these deals often contain an element of subsidy, since destinations are keen to attract services by the LCCs. These subsidies too are coming under the scrutiny of the courts and regulators.

While subsidies to airlines are restricted or prohibited, there are cases of specific routes which are allowed to be subsidised. Thus thin routes to remote locations can be subsidised by the member country governments. Granted this, there are attempts to subsidise routes rather than airlines, and to make the subsidy available to the airline which puts in the best tender to serve the route.

Comparisons and Contrasts with the ASEAN Situation

The European experience is relevant for the ASEAN region, but there are important ways in which the two regions, and their air transport markets, differ. These need to be recognised.

The process of moving to Open Skies used in Europe is not feasible in the ASEAN situation. As noted, liberalisation was driven by a central authority, and enforced by a central court.

These do not exist in the ASEAN case. The countries of ASEAN have not concluded an agreement which will require them to move to Open Sky.

Most of the airlines in Europe had comparable levels of productivity and faced similar input costs. They were thus well placed to compete with one another. In contrast, there is a wide dispersion in ASEAN of airline productivity levels, and input prices. As a result, some airlines in the ASEAN region are much more cost competitive than others. This makes it difficult to make an early transition to competition.

In most of the European countries, incomes per capita are high, and there is a well developed tourism market. Residents travel on business and leisure extensively, and air transport markets are dense. Tourism destinations have well established facilities. By contrast, in the ASEAN region, there are only a few countries with incomes high enough to generate substantial tourism, and many of the tourism destinations have great potential, but have yet to be able to realise that potential.

Related to this, there has been a large charter airline market in Europe, oriented to serving leisure travellers. This market has provided some indirect competition for the scheduled market, and it has provided the opportunity for airlines to develop their experience in low cost operation. In ASEAN, there is little experience of charter operations, and no dedicated charter airlines.

Another factor of relevance in Europe is the strength of surface transport. Most air transport routes face strong competition from surface transport- roads and rail in particular. This provides some discipline on pricing. While surface transport is important in ASEAN, it is usually much slower than air transport, and serves a different market segment.

Infrastructure access is a problem in Europe- many airports are slot constrained or congested, and air space is congested. This is not the case in most ASEAN countries- airport congestion is limited, and air space is not congested. To this extent, a move to Open Sky would be easier in the ASEAN region.

Finally, in Europe, the market for capital, and in particular, risk capital is very well developed. Airlines are able to obtain finance readily- this also applies to new, untested airlines. While some capital markets in the ASEAN region are well developed, this is not so for the whole region. Airlines, and in particular, new airlines, may find obtaining finance a problem in some areas.

Lessons from European Open Skies

While care must be exercised in making generalisations, it is possible to draw some conclusions from the European experience.

While competition between established national carriers increases when there is a move to Open Skies, this only happens to a limited extent. The initial move to Open Skies was not accompanied by a sharp increase in competition.

Low Cost Carriers are an important and dynamic part of the liberalisation process. When they set up and enter city pair markets, they greatly increase the competition in them, and lead to lower fares.

Most routes, except the very dense routes, do not have more than two carriers competing. If they are genuinely independent, and especially if one of them is a low cost entrant, this will be sufficient for a moderately competitive outcome.

The older full service flag carriers have been forced to adapt to competition from the low cost carriers. Some have experienced difficulties, though most have been able to weather the challenge so far.

Competition authorities have had to be vigilant in policing Open Skies, and ensuring that anti competitive practices are not resorted to. It has, however, been feasible to work out solutions to competition problems, such as predatory behaviour, state subsidies and anti competitive alliances.

Market access has been critical- it has led to extensive network development by the new carriers which would have been impossible under the old bilateral arrangements.

Finally, the low cost carriers have not just competed on dense markets, but they have played a valuable role in opening up secondary destinations and neglected regions- they have been willing to serve thin routes and develop new destinations- partly because they have avoided direct competition with the large airlines by doing so.

<u>The Pacific Islands Air Services Agreement (PIASA)</u>[3]
PIASA was developed by the Forum Secretariat at the request of Ministers through the 1998, 1999, and 2001 Forum Aviation Policy meetings. The final text is due to be signed by Forum Leaders in 2003.

In some respects the aviation sector in the region is already benefiting from liberalisation developments, but in other areas it lags behind. The 14 island members of the Forum are parties to 67 bi-lateral air services agreements, 25 of which are between Forum Island Countries (FICs) only. This proliferation of agreements has made gaining multiple international route approvals in the Pacific region a difficult and time-consuming task and is believed to have acted as a brake on multi-destination tourism, inward investment, and industry development.

Proposed Benefits
The Forum believes there are many benefits to be had as the current system of 25 inter-Forum Island Countries bi-lateral agreements is replaced by a unified multi-lateral agreement, including:
a) expanded inter-island tourism and reinforced thinner regional air routes
b) maintenance and improvements in safety standards
c) increased FIC airline access to air routes between FICs
d) expansion and efficiency improvements for FIC airlines
e) greater use of code-sharing and alliances
f) greater cargo options for exporters and importers
g) cost savings to airlines which can be shared with users.

In the Forum's view, PIASA sets out an ambitious, but achievable, programme that will deliver long term benefits to island economies by creating a regulatory framework that will equip the FIC airlines to operate in an increasingly competitive global and regional commercial environment.

The Forum did not conduct an economic impact study nor an operational analysis of possible outcomes.

Rationale
In the emerging global system, smaller governments do not have the resources or the power to deliver the protection to air services that they could previously. Adaptation to market

[3] Adapted from papers given to ICAO's 2003 'Liberalisation Conference'

forces has become essential. Code-sharing and market consolidation are creating a totally new operating environment, where some smaller airlines risk being marginalised and eventually excluded from the market. PIASA is designed to support the airlines of the Pacific region in adapting to coming changes and to take hold of the opportunities offered proactively, rather than to rapidly react to changes forced upon them.

PIASA is intended to provide, through the creation of a Forum Island Country Single Aviation Market, a gradual, staged process which will assist in the strengthening and growth of FIC airlines. PIASA aims to place the control of change in the hands of FICs, rather than having changes forced upon FIC airlines at a pace determined by external factors. The Agreement allows FIC airlines to develop within the region first, and to establish stronger relationships with major airlines and alliances. The three phases of PIASA apply only to services between the Forum Island countries. PIASA does not apply to air services between FIC and non-FIC countries (which will continue to be governed by bi-lateral agreements), nor does it give any additional rights to airlines designated by non-FIC countries. For these reasons, the initial impact within FICs is expected to be small.

Implementation

PIASA places great importance on implementation, through three stages of increasing liberalisation. The step-by-step scheme describes a gradual process designed to allow governments and airlines to adapt as the system is introduced

This phasing process addresses two main issues:

1. Progressive liberalisation of market access, moving in the second step to unlimited internal Fifth Freedom operations between the island states and in the final phase extending to allowing beyond Fifth Freedom rights where the third country involved permit it; and
2. Relaxation of restrictions on national ownership of airlines, and in particular in terms of limited access to capital funding, as the FICs' national economies are extremely small.

Ownership and Control

There are two phases for the transition to what is effectively a community ownership and control regime, the first after six months effectiveness and the second after 30 months.

Stage 1 permits designation where the designated airline is substantially owned and effectively controlled by one or more of the Parties to the Agreement and/or their nationals. This stage also signals the subsequent broader regime by permitting a state with no existing flag carrier to designate another country's airline, so long as "its place of residence and principal place of business (is) in the territory of the designating Party".

There is no change under Stage 2, but by Stage 3 an option is provided, extending the earlier use of place of residence and business to all FICs. Thus, the Agreement permits designation subject to the airline being:

- Substantially owned and effectively controlled by one or more of the Parties to this Agreement and/or their nationals; or
- (Having) its place of residence and principal place of business in the territory of the designating Party.

Many of the clauses contained in the PIASA appear in various bi-lateral and multi-lateral agreements that have been developed in recent years, so are not expected to be controversial. Important protective measures include:

a) staged implementation with protection for FIC during adjustment phases
b) maintenance of current safety and security requirements
c) allowance for code-sharing and alliances
d) mechanisms for consultation, amendments and review
e) rules for fair competition and pricing
f) allowances for transparent subsidies to ensure maintenance of social services
g) dispute settlement mechanisms.

A vital feature of a multi-lateral open system or Single Aviation Market is the removal of government intervention in commercial decisions, implying generally increased levels of competition between airlines.

For a fragile airline system it is important however to avoid such practices as predation and capacity dumping. Annex 2 of the Agreement provides some assistance in this respect by setting out "Indicators of possible Unfair Competitive Conduct". Annex 3 then offers guidelines for dispute resolution, in support of the clauses in the main Agreement.

PIASA has not been designed as the complete answer to air transport problems in the Pacific. It is however, one component, along with issues such as infrastructure constraints (especially hotels), which are holding back growth.

Consultation between stakeholders is an important aspect of implementation. Governments, airlines, tourism industry, and airfreight users are among those who have interests in the outcomes.

Other Views of PIASA
There are dissenting views about the value and utility of PIASA. In view of the emerging multi-lateral air service regulation in the Pacific Island region and in other parts of the world, it is essential for a developing country with relatively small aviation resources to reassess the current economic regulatory framework for its international air services. The increasingly worldwide trends towards liberalisation, globalisation, integration, multi-national ownership of airlines and profound advancement of code-sharing are merely economic forces fuelled by developed countries with matured economies and therefore must not be imposed on developing countries because of inherent economic disparities. This is the argument put by some countries.

ASPA's View
From an airline perspective, the voice of the Pacific island carriers, through the Association of the South Pacific Airlines (ASPA), cannot be ignored because in the final analysis the airline operators will be directly affected by any radical changes to the economic regulatory framework for air services in the region. The Fiji Government equally shares the concern of ASPA as it also mirrors the position of its majority owned carrier, Air Pacific.

ASPA has some concerns about liberalising the regions air services on a multi-lateral basis. It argues that the national carriers of the region warrant relative protection from "unnecessary" competition on some profitable routes which have been developed by and invested in by Pacific island carriers, especially those routes where the Fifth Freedom rights will be introduced under the multi-lateral agreement. Some national carriers in the region are currently operating in high cost circumstances in thin markets and are being faced with difficulties in flying profitably within the regional routes. In general, the potential risk of over exploitation of the Fifth Freedom rights within the region would undoubtedly expose all the Pacific island carriers to a danger zone with high commercial risk.

ASPA cites examples of what might happen in an open market environment such as that of the domestic aviation industry in Australia and New Zealand. The collapse of three domestic carriers: Ansett, Impulse and Flight West in Australia and the Qantas franchise in New Zealand, are profound manifestations of what could potentially emerge if the Pacific moves towards an internal or single open skies arrangement. ASPA argues that the carriers were victims of regulatory change and as a result, competition in the domestic aviation markets of Australia and New Zealand has diminished (but note the entry of Virgin Blue). So far as ASPA is concerned, the fundamental need is to ensure the sustained viability of Pacific carriers in an "open skies" environment where they will compete amongst themselves. ASPA believes that any proposed change in the regulatory framework has to be appropriately triggered by the carriers according to their level of development and maturity and also in terms of their preparedness or readiness to expose them to the risk of open and "uncontrolled" competition. ASPA fears that opening up routes to competition would likely lead to an undesirable situation whereby some small Pacific carriers would not be able to cope with the internal competition, and thus could potentially vanish. The "survival of the fittest" scenario is not compatible with the financial health of most Pacific carriers who are operating in thin markets characterized with fragile economies.

ASPA is therefore of the view that national carriers of most Forum Island Countries are entitled to an appropriate level of protection on their main catchment routes within the region to enable them to sustain air services. Third and Fourth Freedom traffic rights are the lifeline of their operation. Any change to the current situation, particularly unrestricted access to the Fifth Freedom traffic between island countries, would only bring more commercial damage to these developing carriers. At present, most Pacific island countries have Third and Fourth Freedom rights with one another. However, with the introduction of a multilateral agreement, each Pacific country is obliged to grant Fifth Freedom rights amongst themselves. There is potential therefore that an open oriented air service arrangement would easily entice Pacific island carriers (after Third and Fourth Freedom) to fly to a second country picking up Fifth freedom traffic on an already thin market.

Furthermore, ASPA asserts that the Forum Secretariat is yet to provide a convincing economic rationale behind this free trade of Fifth Freedom traffic within the region. The Forum Secretariat knows that not every Pacific carrier will be able to compete on an equal basis with others because of the inherent inequalities that exist in the Pacific carriers or even will have the capacity to fully utilise these Fifth Freedom opportunities.

Air Pacific's View

ASPA's view reflects the position of Fiji's national owned carrier, Air Pacific. The Fijian Government accords a high priority to the future viability of Air Pacific. Air Pacific's position is that bilateral arrangements have and always will facilitate and enhance Fiji's international profile as an attractive tourism destination in its own right, as opposed to becoming a multi-tourist destination in a multi-lateral arrangement or PIASA. Air Pacific believes that bilateral arrangements remain appropriate for Fiji as an effective means of specifically tailoring its bargaining power to meet national interests in free or open markets.

Fiji's View

The views of both ASPA and Air Pacific complement the position adopted by the Fiji Government with respect to PIASA. The Fiji Government has undertaken explicitly not to accede nor sign the new multilateral air service agreement until a further review is undertaken.

The main premise for introducing multilateral "open skies" in the region is the need to adjust Pacific Island nations international air services to reflect the new economic realities of the global market. The fundamental question for Fiji is whether it should support an "open skies" regime within the region or maintain the present bilateral approach in an attempt to ensure the survival of its nationally controlled airline in the regional aviation market. The current thinking of the Fiji Government is that the national airline concept is still appropriate in the current context of liberalisation of air services. This implies a continuation of bilateral negotiations as opposed to a multilateral arrangement. Fiji will not be a party to any regional undertaking on any airline service regulation matters that would unnecessarily pose new problems to the growth and development of its aviation institutions, particularly Air Pacific.

Furthermore, Fiji attaches importance to the recognition of the principle of national sovereignty over airspace given the failure of the 1944 Chicago Convention to reach a multi-lateral agreement on the exchange of air traffic rights. The current practice of USA, Australia and New Zealand in each employing a unilateral approach to their bilateral negotiation and discussion on "open skies" arrangements with their aviation partners clearly reinforces the position taken by Fiji not to give in easily to multi-lateral pressure as it is against its national interest.

Accordingly, Fiji will continue to pursue or negotiate for the most liberal air service arrangements with its bilateral partners because in its view such agreements generally resulted in greater benefit for the national interest. Fiji also observes that there has been no proven or compelling quantitative assessment of the efficiency, or otherwise, aspects of the current bilateral system or of the advantages of replacing it with a multilateral system.

The current bilateral agreement have not in any way inhibited technological and marketing innovation or inter-airline commercial arrangements and, on this basis, Fiji will continue to use its current bilateral agreements as an instrument for adaptation of its international air service to the rules and principles of the WTO.

3.2.4 Asia Pacific Economic Cooperation (APEC) Open Skies Initiatives

The APEC economies are moving cautiously towards Open Skies. Guidelines for regional aviation liberalization by member countries of APEC were developed in the mid 1990s. The APEC Air Services Group (ASG) identified eight options for regional aviation liberalisation at its meeting in Singapore in October 1995. These were endorsed by the APEC Transportation Ministers in 1997, ASG being further instructed "to analyse and prioritise the eight options and prepare, on a consensus basis, a recommendation on the options to be developed and how they should be implemented."

ASG achieved consensus on the following options:

Option 1: Air Carrier Ownership and Control (Medium Priority)

ASG recommends that APEC economies consider broadening the airline ownership and control requirements embodied in ASAs between member countries using the framework developed by ICAO's Air Transport Regulation Panel:

> "That States wishing to accept broadened criteria for…market access in bilateral or multilateral air services agreements agree to authorize market access for a designated air carrier which: (a) has its principal place of business and permanent residence in the territory of the designating state; and (b) has and maintains a strong link to the designating state."

Option 2: Tariffs (Medium Priority)

ASG recommends that APEC economies support the removal or progressive easing of tariff regulations in bilateral or multilateral air services agreements where this promotes competitive pricing to the benefit of consumers. ASG notes that a 'double-disapproval' regime (see above) might be introduced.

Option 3: Business Practices (High Priority)
ASG recognizes that the development of competitive air services depend, inter alia, on minimizing restrictions to which airlines are subjected and/or removing or reducing discrimination between airlines serving the market in question. For example, airlines may face restrictions relating to ground handling arrangements, remittance of earnings, and access to computer reservation systems. ASG recommends that APEC member economies work towards the removal of such impediments.

Option 4: Air Freight (Medium Priority)
Recognising that the facilitation of air freight services may assist in promoting trade between APEC member economies, and also that the air cargo market has features that (partially) separate it from the passenger market, ASG recommends that APEC economies progressively remove restrictions on the operations of air freight services, aiming to provide additional flexibility and capacity for air freight between APEC member countries.

Option 5: Multiple Airline Designation (High Priority)
Noting that growth in the number of airlines providing services within the region adds to competition and provides greater choice for consumers, ASG recommends that APEC economies consider multiple airline designation in their ASAs.

Option 6: Charter Services (Medium Priority)
ASG recommends APEC economies facilitate the operation of both passenger and freight charter services to supplement or complement scheduled services.

Option 7: Airline Cooperative Arrangements (High Priority)
ASG recommends that APEC economies facilitate cooperative arrangements between airlines (e.g. code sharing, joint operations and block space arrangements) 'where it can be shown to be of benefit to consumers and airlines and where there are no anti-competitive effects.'

Option 8: Market Access (Medium Priority)
ASG members agreed with the recommendation that APEC economies adopt an approach leading to progressively more liberalized market access, while ensuring fair and equitable opportunities for member economies.

Whilst in its infancy, the APEC initiative is of interest not only because a number of ASEAN member economies are members of APEC but because some of the options and priorities identified by the TWG might be adopted – perhaps in a modified form – in any ASEAN liberalization.

The next sections focus on the Latin American Civil Aviation Commission, the Caribbean Community Multilateral Air Services Agreement and the Yamoussoukro Agreement of Africa. Selected provisions from other regional agreements such as the Andean Pact and the Banjul Accord are also presented in Table 3.2 (ICAO, 2001).

3.2.5 Latin America (Latin American Civil Aviation Commission)

According to a paper given at the recent ICAO Liberalisation Conference (2003), aviation markets among Latin American countries are slowly becoming more flexible through sub-regional and bilateral agreements. The Latin American Civil Aviation Commission (LACAC) is said to be promoting aviation initiatives such as those forming part of the Fortaleza Agreement and the Andean Community of Nations. However, the impression gained from the paper is one of slow progress. Whilst a number of nations are convinced that regulation and restrictions hinder growth, others are concerned about the nature of competition in liberalized markets.

3.2.6 Caribbean Community (CARICOM Multilateral Air Services Agreement)

The Caribbean Community (CARICOM) was set up by Barbados, Guyana, Jamaica and Trinidad and Tobago in 1973. The membership of CARICOM has since increased to fifteen members, representing a total population of about 15 million. Chapter Six of the Revised Treaty of Chaguaramas (the Caribbean equivalent of the Treaty of Rome) establishes the basis for Community Transport Policy, including general provisions relating to the provision of air transport services within the Community. More specifically, the CARICOM Multilateral Air Services Agreement (CARICOM MASA), which entered into force in 1998 and is presently in force between nine member states, provides for the exchange of route and traffic rights within the Community.

The main features of CARICOM MASA are:

- The Agreement is concerned solely with CARICOM carriers;
- Multiple designation is permitted, but account must be taken of market characteristics and the likely impact of new operators on the operation of existing carriers;
- Traffic rights covered by the Agreement include the right to carry traffic between a Contracting State in which a carrier is registered and another Contracting State and, on a reciprocal basis, the right to carry traffic between another Contracting State and beyond;
- Contracting States are not obliged to grant cabotage rights to the carrier of another Contracting State, neither is there a prohibition to grant such rights;
- Tariffs are required to be submitted for approval and are deemed to be approved if neither of the States concerned expresses disapproval within a specified period;
- The Agreement provides for fair and equal opportunity for all CARICOM air carriers; and
- There is no provision for the direct control of capacity on any route.

CARICOM MASA is at an early stage of development. As with European liberalization, the impetus stems from a central authority, CARICOM. The fact that only nine out of fifteen member states have joined CARICOM MASA suggests that the willingness to liberalise is muted. We are not aware of any study into the costs and benefits of the arrangement.

TABLE 3- 2 FEATURES OF SELECTED REGIONAL OPEN SKIES AGREEMENTS

ANDEAN PACT (1991)	CARICOM (1996)	FORTALEZA AGREEMENT (1997)	BANJUL ACCORD (1997)	CLMV AGREEMENT (1998)	COMESA (1999)	ACAC (1999)	YAMOUSSOUKRO AGREEMENT (1999)
NON-SCHEDULED SERVICES							
Permits unrestricted all-cargo flights and inclusive passenger charters within the region which do not endanger the stability of existing scheduled services	No provision	No provision	No provision	No limitation subject to permission procedures of each member country	Permits free movement of intra-COMESA air cargo and non-schedule passenger traffic	No restriction subject to regulatory procedures	Permits “eligible airlines”, subject to operating certificates and corresponding insurance policies. Preference given to scheduled airlines operating on the same sector.
THIRD AND FOURTH FREEDOM TRAFFIC							
Yes	Yes – when licensed and with prior notification: day tour/air taxis may be subject to uplift/direction conditions	Yes, but only on routes not covered by bilateral agreements	Yes, for two traffic points in each state	No limitation on $3^{rd}/4^{th}$ Freedom traffic rights. No limitation on eight international airports for origin, destination, intermediate and beyond points within the region	Up to 2 daily flights between any city pair, beyond that bilateral air service regs apply. No intra COMESA limitation	No restrictions beyond 2001	No limitations

ANDEAN PACT (1991)	CARICOM (1996)	FORTALEZA AGREEMENT (1997)	BANJUL ACCORD (1997)	CLMV AGREEMENT (1998)	COMESA (1999)	ACAC (1999)	YAMOUSSOUKRO AGREEMENT (1999)
TARIFFS							
Country of origin	Dual approval required by States concerned. Tariffs must meet general criteria	Country of origin tariffs applied. Can be examined by Council of Aeronautical Authorities	Double approval tariffs fixed on basis of price caps based on operating cost of designated airlines	Dual disapproval for sub-regional tariffs	No specific provisions	By 2001, apply rules of supply and demand for tariffs	Tariff increases: no approval, 30-day filing before tariff comes into effect. Tariff decreases: immediate effect.
OWNERSHIP AND CONTROL							
Determined by national law	Air carrier must be owned and controlled by one or more member States or nationals thereof	No specific provision	Headquarters and major operations in designating State	No specific provision	Air carriers should be substantially owned and effectively controlled by one or more COMESA members or their nationals	Air carriers should be substantially owned and effectively controlled by Arab States or their nationals	Airline to have its central administration and principal place of business physically located in a State Party to the Agreement. Aircraft to be fully owned or on long term lease and effectively controlled.
CAPACITY							
Free exercise of 3rd, 4th and 5th freedoms, but non-scheduled flights on scheduled service routes may not endanger the	Primary objective is the provision of capacity adequate to meet current and reasonably anticipated requirements for the carriage of passengers, cargo and mail on specified routes	Capacity must be adapted to traffic potential. Member States to evaluate airline proposals in order to avoid excess capacity	Five frequencies per week per airline. Schedules should be harmonized	No limitation on capacity or frequency	No restrictions on type and capacity of aircraft, except for airport operating limitations and airworthiness requirements	No restriction on type of traffic or points of operation. Capacity freeze can be imposed for one year, non-renewable, in the case of	No limitation except for environment, safety, technical or other special consideration. Additional capacity subject to rules re fair competition.

ANDEAN PACT (1991)	CARICOM (1996)	FORTALEZA AGREEMENT (1997)	BANJUL ACCORD (1997)	CLMV AGREEMENT (1998)	COMESA (1999)	ACAC (1999)	YAMOUSSOUKRO AGREEMENT (1999)
viability of scheduled services						rapid decline in market share	
COMPETITION POLICY							
Competition rules of Andean Pact apply to air transport	Accords airlines fair and equal opportunity to compete. Requires action to eliminate all forms of discrimination and unfair competitive practices	Members to adopt measures to eliminate all forms of discrimination and unfair competitive practices. Establishes a national standard for treatment of airlines of other member States	No specific provisions	No specific provisions	Members to apply COMESA competition rules and regulations to alliances and other commercial arrangements	Apply ICAO guidelines and rules of the Arab League re fair competition and non-discrimination. Existing bilateral agreements used for resolution of disputes	Equality of opportunity on non-discriminatory basis to allow airlines to compete effectively in providing air transport services
FIFTH AND SIXTH FREEDOM TRAFFIC							
Allows 5th Freedom Traffic. No mention of 6th Freedom	5th: to be exchanged between members on a reciprocal and liberal basis 6th: not mentioned	Carriage of 5th and 6th Freedom traffic permitted only with consent of States concerned	5th: Unrestricted. Where no 3rd and 4th freedom operators, 5th freedom limited to 20% of capacity	5th: no limitation on traffic 6th: implicitly recognized from traffic points description (see above)	5th: unrestricted. Where no 3rd and 4th freedom carriers, limited to 30% of capacity.	5th: no restriction by 2005	5th: limits commitment for a period no longer than 2 years.
MULTIPLE DESIGNATION							
Yes	Yes, except where it would lead to serious financial losses for	Yes	Maximum of 2 airlines per State	Yes	Yes	Yes	A member State may designate:

ANDEAN PACT (1991)	CARICOM (1996)	FORTALEZA AGREEMENT (1997)	BANJUL ACCORD (1997)	CLMV AGREEMENT (1998)	COMESA (1999)	ACAC (1999)	YAMOUSSOUKRO AGREEMENT (1999)
	existing carriers licensed by both States						- a minimum of one airline - an eligible airline from another member State to operate services on its behalf - an eligible African multinational airline
OTHER PROVISIONS							
May not impose restrictions on any facilities that member nations have granted or may grant through bilateral or multilateral negotiations	Shall not affect any bilateral, multilateral or other contractual agreement	May not introduce restrictions which contravene ASAs among member states	Prior consultation and observer status for member states not parties to bilateral negotiations. In event of inconsistencies, Yamoussoukro Declaration prevails	Existing bilateral ASAs recognized. Progressive implementation. Any two states may initiate cooperative arrangements. Other states may join when ready.	Existing bilateral ASAs recognized. Progressive implementation. Alliances and commercial arrangements encouraged	Existing ASAs recognized. Progressive implementation. Alliances and marketing arrangements encouraged	Decisions have precedence over any incompatible multilateral or bilateral provisions in ASAs between two member States. Agreements not incompatible remain valid and supplement the decision.
NON-MEMBER STATES							
Permits non-scheduled cargo flights between Member and Non-Member States. 5th Freedom rights	Does not affect bilateral agreements/arrangements or operating licenses. Similar authorizations already in force between a member and a non-member State	No specific provisions	See 'Other Agreements'	Existing bilateral ASAs recognized	Existing bilateral ASAs recognized	No specific provisions	See 'Other Agreements'

ANDEAN PACT (1991)	CARICOM (1996)	FORTALEZA AGREEMENT (1997)	BANJUL ACCORD (1997)	CLMV AGREEMENT (1998)	COMESA (1999)	ACAC (1999)	YAMOUSSOUKRO AGREEMENT (1999)
exchanged with non-member States on basis of equity and adequate compensation							
INCLUSION OF NEW MEMBER STATES							
Presumably requires State to join Andean Pact	Open to State or Territory which becomes a member of the Caribbean Community	Open to other South American States. Requires unanimous approval of existing members	No provisions	Open to other countries subject to acceptance by all member States	No provision	No provision	No provision
ENTERED INTO FORCE							
June 1991 (Decision 297)	December 1998	30 days after third ratification deposited	January 1998	1st Phases of liberalization scheduled for October 1999	1st Phase of liberalization scheduled for October 1999	1st Phase of liberalization scheduled for 1999	30 days after the date of its signature by the Chairman of the Assembly of Heads of State and Government
AMENDMENTS							
By decision of Cartegena Commission	After eighth ratification (December 1998)	By unanimous agreement of aeronautical authorities	No provisions	All parties must accept proposed amendments	No provisions	No provisions	After 2 years, or earlier if requested by two-thirds of members

Source: ICAO (2001)

3.2.7 Africa (Yamoussoukro Agreement)

The genesis of African liberalization came with the Yamoussoukro Ministerial Declaration of 1988. The Declaration included a number of provisions relating to the integration of African airlines, enhanced flexibility in the granting of 5th Freedom traffic rights, measures leading to the improvement of airline management and financing. After a decade of limited progress, African Ministers decided to liberalise access to air transport markets in 1999. When fully implemented, the new Yamoussoukro Decision will eliminate all barriers and restrictions relating to:

- The granting of 5th Freedom Traffic Rights;
- Capacity;
- Tariffs; and
- Air freight operations.

The new Yamoussoukro Decision was adopted by the Assembly of Heads of State and Government of the Organisation of African Unity/African Union in July 2000.

Whilst the liberalization initiative is relatively recent, a paper given to the ICAO Liberalisation Conference (2003) suggests that various effects are already being felt:

- New services have been introduced;
- Service frequencies have been increased;
- Fares have fallen (by up to 30%) and consumers have a wider choice of fare types;
- Incomes of airlines, airport authorities, and airline agencies have increased;
- Competition has developed where warranted by traffic volumes, leading to an improvement in the quality of service and an increase in the range of fare types;
- The private sector has begun to show an interest in providing air services; and
- The survival of some airlines operating below capacity is at risk.

3.2.8 Sub-Regional Liberalisation (BIMP-EAGA and IMT-GT)

In 1995, the governments of Brunei, Indonesia, Malaysia and the Philippines signed a Memorandum of Understanding (MOU) designed to expand and strengthen air services in the BIMP-EAGA. The MOU provided for full 3rd and 4th freedom traffic rights, without any restrictions on capacity, frequency and aircraft type, unless otherwise predetermined by existing bilateral agreements. While cabotage rights were not affected, airlines were given coterminal rights. Further liberalization took place in 1999 and 2000. Brunei, Indonesia and the Philippines have all agreed to granting full 5th freedom traffic rights within BIMP-EAGA. Malaysia, on the other hand, agreed to grant the same rights on a case-by-case basis.

3.2.9 Open Skies Initiatives

Initiated by the United States and the Netherlands in 1992, bilateral open skies agreements have flourished as a vehicle to open up hitherto restrictive aviation markets (La Croix and Wolff,1995). In 1996, the US signed open skies agreements with nine other European countries. These allowed for open entry on all routes unrestricted capacity and frequency, expanded route flexibility and fifth freedom operations, a double disapproval fare structure, code sharing opportunities and enhanced access to computerized reservation systems. However, they did not liberalize provisions on foreign ownership or allow foreign carriers access to domestic markets.

In the past decade, bilateral open skies agreements have been widely accepted as the most appropriate framework for liberalization. Developing countries, in particular, have used them to exploit opportunities from trade, investment and tourism. The success of open skies agreements is said to rest on the opportunities they create rather than equality of outcomes

(Tretheway, 1997). Some bilateral open skies agreements have opted to treat air cargo as the lead sector, notably South Korea and Germany, Philippines and the United States, and the Southeast Asian region. In contrast, Australia opened up its international aviation market by allowing foreign carriers access to secondary gateways, such as Perth.

To date, the United States has signed bilateral open skies agreements with 59 countries (including Taiwan, South Korea, Malaysia, Singapore and Brunei). These agreements vary in their degree of openness and in the sequencing of liberalization.

US – Canada (1995 Open Skies Agreement)
Having followed an essentially conservative policy in the 1980s and early 1990s, Canada adopted a new and more liberal international aviation policy in 1994. The policy sought to provide consumers with greater choice by adopting a ‘use it or lose it’ approach to Canada’s international route rights and by facilitating foreign carrier access to the Canadian market. In 1995 Canada adopted a multiple designation policy for markets of over 300,000 scheduled one-way passenger trips a year. Commencing in December 1999, any Canadian carrier may provide scheduled services to any international market exceeding the 300,000 trip threshold, subject to the availability of bilateral rights.

The showcase of North American liberalization is the Open Skies Agreement entered into by Canada and the US in early 1995. The main elements of the Agreement include:

- Canadian and US airlines are free to provide unrestricted cross-border services (i.e. without restriction on capacity, frequency and aircraft size);[4]
- The 1995 Agreement provided Canadian carriers with a limited number of slots at Chicago (O’Hare) and New York (La Guardia) Airports;
- The process for approval of Canada-US fares was liberalized; and
- Canadian and US airlines are able to operate unrestricted cross-border cargo services[5]

Following the signing of the Agreement, air traffic between Canada and the US increased substantially - from 13.6 million passengers in 1994 to almost 20 million in 1999. Most travellers have choice on transborder routes. As of December 2000, routes from Toronto, Vancouver and Calgary were served by nine, eight and six US carriers respectively. The June 2001 *Report of the Canada Transportation Act Review Panel* notes that while only one or two carriers offer direct flights from Canadian airports to specific US destinations, the availability of connecting services through US hubs limits the prices that can be charged for non-stop services between Canada and the US.

On the negative side, as noted above, it is possible that competition from US carriers has been a factor in the financial difficulties which Canadian Airlines International and more recently Air Canada have faced. However, Air Canada’s bankruptcy appears to have been the result of poor investment and management decisions. Whilst Air Canada’s acquisition of Canadian Airlines in 2000 held out the promise of improved profitability, primarily as a result of enhanced share of the domestic market, the carrier’s performance actually deteriorated following the takeover. Not only did the takeover raise competition policy concerns, leading the government to insist Air Canada surrender airport facilities and give up landing slots, but the acquisition appears to have hindered Air Canada’s adjustment to the post 9/11 world. Air Canada is a full service airline, characterized by a rigid cost structure and low productivity, attempting to compete in its domestic market against discount airlines, such as Westjet, with

[4] US airline services to Montreal and Vancouver were to be phased in over two years, services to Toronto – the major hub - were to be phased in over three years.
[5] Freight services by US carriers to Montreal, Toronto and Vancouver were limited for the first year of the Agreement.

markedly lower cost structures. Air Canada's attempts to compete, using low-fare brands such as Tango (long haul) and Zip (short haul), appear to have diluted demand for the airline's core services. Some commentators have argued that Air Canada's business model is simply unsustainable in the post 9/11 environment.

In short, whilst further research is required on the impact of the 1995 Agreement, there is widespread acceptance of the public benefits of the 1995 Agreement. The recent blueprint for transport development in Canada, *Straightahead: A Vision for Transport in Canada* notes that the Canadian Government will continue the gradual liberalization of Canada's bilateral air agreements, using the 1995 Canada-US Open Skies Agreement as a model.

3.2.10 Open Skies in Asia

The relatively high rates of Asian economic growth in the 1990s exerted pressure on Asian governments to liberalize their domestic and international aviation sectors. Bilateral open skies agreements have become the most popular way of removing restrictions in Asian markets. While the ASEAN Framework Agreement on Services (AFAS) created opportunities to lower barriers to trade in services, it did not cover the aviation sector. We note that economists argue that bilateral open skies agreements work best if they are part of a broader reform package including trade in goods and services.

The extent and sequencing of liberalization varies across Asian countries. In the Philippines, privatization of the national carrier took place before deregulation of the domestic and international aviation markets. In other countries, deregulation occurred before the privatization of the national carrier. Policies relating to the opening up of major and secondary gateways also differ. Some bilateral agreements (e.g. Philippines and Vietnam, Indonesia and Singapore, Indonesia and Taiwan) provide for the opening up of relatively undeveloped secondary gateways on a bilateral basis. In 1994, in order to increase tourist and business traffic to Indonesia, the Indonesian government opened up ten secondary markets to Singapore, enabling Silk Air to expand its network. Other agreements have liberalized fifth freedom traffic rights beyond Southeast Asia. For example, the Thailand-Taiwan Agreement liberalized fifth freedom rights in order to promote Thailand as a regional hub and gateway to Europe.

<u>Australia-New Zealand</u>

As noted above, Australia and New Zealand have formed a single aviation market, which came into being in the 1990s. This meant that airlines from both countries could operate within and between the two countries unhindered, though restrictions on beyond rights still remain. The workings of this market have been considered in Findlay and Kissling (1997) and by the Productivity Commission (1998).

To date, airlines have not made full use of the rights which are available. For example, neither Air New Zealand nor any other New Zealand based carrier has entered the Australian domestic market.[6] We note that since the formation of the single aviation market, the Australian domestic market has been opened to 100% foreign owned carriers since 1999, leading to the entry of Virgin Blue.

[6] Air New Zealand's attempt to enter the Australian domestic market via the acquisition of Ansett proved an expensive mistake.

4. AVIATION POLICY AND THE AVIATION INDUSTRY IN ASEAN COUNTRIES

This chapter focuses on current aviation policy and the state of the aviation industry in ASEAN member countries. The chapter draws from individual country studies undertaken by members of the team. These studies are based on information from secondary sources and gathered and consultations conducted during the fieldwork (see Appendix 4).

4.1. Introduction

To begin with, it is important to recognize that the member countries of ASEAN differ significantly from each other in a number of ways that are important to the aviation industry.

The scale of today's aviation sector depends not only on the per capita income level of ASEAN countries, but on their attractiveness to foreign tourists and their ability to transform themselves into airline hubs. Per capita income varies from approximately US$125 in Myanmar, US$270 in Cambodia and US$410 in Vietnam to US$3,330 in Malaysia, US$12,558 in Brunei Darussalam and US$21,500 in Singapore. Not only does Singapore attract airline traffic because of its pivotal hub position and its attraction to tourists, but Singapore's residents have discretionary income that can be spent on foreign travel. As a result, a relatively high proportion of Singapore residents travel abroad.

The potential for future growth of the aviation sector depends not only on the rate of economic growth achieved by ASEAN members but on their geography and population. We note that the geographic size of ASEAN members varies greatly. Compare the land area of Singapore (68,000 hectares) and Brunei Darussalam (527,000 hectares) with that of Vietnam (330,000 square kilometers). Whereas the island state of Singapore has no domestic aviation market, countries such as Indonesia, Thailand, and the Philippines have large domestic aviation markets (actual or potential). There is potential for aviation development in archipelagic countries such as Indonesia and the Philippines. We note also that the population of ASEAN members varies from 340,000 in Brunei to 80 million in the Philippines, 80 million in Vietnam and 230 million in Indonesia. The size of the potential aviation market varies greatly across ASEAN member states.

Where the domestic market for travel is undeveloped, due to low per capita incomes, domestic air routes will tend to operate with low traffic densities. This means that frequencies will be low, and smaller, relatively high cost aircraft will need to be used. This leads to the overall average cost of airline operations being higher than for richer countries with busier air routes.

4.2. Aviation Policies

4.2.1. Policy Objectives

National aviation policies not only reflect different objectives but also differences in the constraints facing countries. Objectives and constraints are many and varied, and the balance between the different objectives and the strength of different constraints determines policy preferences. Since countries in ASEAN differ in significant ways, the emphasis they put on objectives may be expected to differ. For example, Singapore, with a floating currency, may not be overly concerned with the foreign exchange earnings of its airlines, whilst Malaysia, operating with a pegged currency, may be highly concerned. Similarly, the availability of managers and labour with skills attuned to the airline industry may not be a constraint in Thailand, but may prove a real constraint for Laos.

Policy objectives may include both economic and non-economic benefits. Economic benefits include: consumer benefits; airline profits; industry growth; enhancement of government revenue; earnings from tourism; job creation and skills development; foreign exchange earnings; and risk reduction and stability. Non-economic objectives may include: enhancement of defence capability and improvement of national security; stronger links with foreign countries; and enhanced safety.

Not only do the objectives of aviation policy differ across countries but the sophistication of the policies adopted and the ability to implement them effectively differ between ASEAN member countries. In general, the more developed ASEAN countries have clear policy objectives and well developed policies for the aviation sector. For example, Singapore's aviation policy focuses on the promotion of Singapore as an aviation hub. If such a policy is to be successful, Singapore has to adopt liberal policies in order to attract airlines to serve it rather than competing destinations. To this end it has been willing to grant market access to foreign carriers. In a world of bilateral aviation agreements, Singapore has been able to obtain market access for its own carrier.

Similarly, Thailand has several broad objectives in the aviation sector:

- To support Thailand's aviation network, promote its status as a regional aviation
- hub and national economic and tourism development centre;
- To expand and upgrade facilities at regional airports in order to extend their capacities to support regional economic expansion, promote tourism, and encourage their optimum use;
- To expedite construction of Bangkok's new airport (Surarnabhumi Airport);
- To implement inter-modal linkages between the aviation, road, rail and maritime sectors

These policies may be compared with those in less developed ASEAN countries. Aviation policies in Myanmar, Laos, Cambodia are not specified in detail and under development. For example, Myanmar does not to have a clearly enunciated aviation policy, preferring to deal with each situation as it arises. In general, these countries are concerned more with sub-regional agreements than with the development of policies across ASEAN or between ASEAN and the wider world.

Not surprisingly, the enthusiasm for liberalizing aviation markets varies across ASEAN. Singapore has traditionally adopted liberal aviation policies. Driven by the perception that its strategic location offered the opportunity to develop a major airline hub, and realizing that liberal policies were necessary if such a hub was to develop, Singapore has been outstandingly successful. As a corollary, Singapore Airlines is able to attract substantial 6th Freedom traffic through Singapore. Singapore acts as a hub for traffic from other continents coming to/from ASEAN.

Malaysia too has adopted a liberal approach to the development of its aviation industry in order to support growth drivers such as tourism. Liberalization of Malaysian aviation policy began in 1993: new entrants were now allowed to compete with Malaysia Airlines, liberal traffic rights were granted to carriers from countries willing to offer reciprocal rights, the government aggressively developed physical infrastructure (notably KLIA) and supported human resource development.

4.2.2. Air Service Agreements (ASAs)

Table 4-1 suggests that the ASEAN countries remain heavily reliant on bilateral ASAs. Whilst the number of active ASAs varies widely across ASEAN member economies, and whilst all countries have a number of inactive ASAs, bilateral airline agreements remain the dominant form of airline regulation.

ASEAN countries are members of a number of multilateral, regional and bilateral Open Skies agreements. Brunei Darussalam and Singapore are signatories to the Multilateral Agreement on the Liberalization of Air Transport. Cambodia, Laos, Myanmar and Vietnam are members of the proposed CLMV regional air services agreement. CLMV provides for unlimited capacity and unlimited traffic rights, including 5^{th} freedom rights across member countries. Limited Open Skies agreements are included in the Indonesia, Malaysia and Thailand Growth Triangle (IMT-GT) as well as in the Brunei Darussalam, Indonesia, Malaysia and the Philippines BIMP-EAGA Agreement. ASEAN members have entered into a rather a large number of bilateral agreements having open skies characteristics. For example, Malaysia has Open Skies agreements with US, Taiwan, New Zealand, Austria, Luxembourg and Lebanon. The extent of liberalization differs considerably across such bilateral agreements.

We note that while Open Skies agreements may not necessarily imply any greater availability of 5th freedom rights, it is likely that an ASEAN member which is concluding an Open Skies agreement with an ASEAN partner may be disposed to allow its airlines on to routes with third countries on a 5th freedom basis. For example, an Open Skies agreement between ASEAN countries might include fifth freedom rights for ASEAN airlines. For example, a Singapore airline might be granted rights to fly from Thailand to India. Fifth freedom rights tend to be granted by countries eager to encourage the development of hub airports, notably Singapore and Thailand.

Several ASEAN members have already exchanged 5th freedom rights. In particular, Thailand has granted extensive 5^{th} freedom rights. The policy appears to have been successful: Bangkok has developed as a hub and Thailand is currently served by 13 non-Thai based ASEAN carriers and 68 non-ASEAN airlines. We note that Thai Airways has been granted limited 5th freedom rights between Singapore and Jakarta and Cambodia has granted 5^{th} freedom rights to Vietnamese carriers for a HCM City/Phnom Penh/Vientiane service.

TABLE 4-1: AVIATION POLICY IN THE ASEAN COUNTRIES

BRUNEI DARUSSALAM	CAMBODIA	INDONESIA	LAOS	MALAYSIA	MYANMAR	PHILIPPINES	SINGAPORE	THAILAND	VIETNAM
INTERNATIONAL AVIATION: AIR SERVICE AGREEMENTS									
36 ASAs. Signatory to Multilateral Agreement on the Liberalization of International Air Transport. Three bilateral Open Skies Agreements (US, New Zealand and Singapore). The 1997 ASA with Singapore removed all restrictions on frequency, capacity and aircraft type. Brunei does not restrict 3rd and 4th freedom route and traffic rights. 5th freedom rights negotiated on a bilateral basis	12 ASAs, 7 of which are with ASEAN countries. Cambodia has granted 5th freedom rights to Vietnam for HCM City/Phnom Penh/Vientiane service. The lack of a strong national carrier means that airline inputs into airline policy are non-existent.	65 ASAs (25 considered active). Limited Open Skies Agreements with Malaysia and Thailand (covering IMT-Growth Triangle) and with Brunei, Malaysia and Philippines under the BIMP-EAGA Agreement	14 ASAs, 5 of which are with ASEAN countries and 6 of which are considered inactive. Government supportive of proposed CLMV Open Skies Agreement. CLMV Agreement provides for full exchange of 3rd, 4th and 5th freedom rights. Laos has flexible agreements with Cambodia and Vietnam. Phnom Penh-Vientiane service is a 5th freedom service operated by Air Vietnam	82 ASAs, 41of which are active. With the exception of Laos, all ASEAN ASAs are active. Open Skies Agreements with US, Taiwan, New Zealand, Austria, Luxembourg and Lebanon. Airlines of these countries are free to operate into any or all of the country's six international airports. Limited Open Skies Agreements with Indonesia and Thailand under IMT-GT and with Brunei, Indonesia and the Philippines under BIMP-EAGA (provides unlimited 5th freedom rights on a case-by-case basis)	45 ASAs, most of which are inactive. Myanmar grants some 5th freedom rights (used by non-ASEAN carriers)	57 ASAs, 22 of which are considered active. Executive Order (E.O.) No. 219 (1995) states that 'The exchange of traffic rights with other countries shall be based on (a) the National Interest…and (b) reciprocity between the Philippines and other countries. It adopts a progressive liberalization policy for the air transport industry in general. Open Skies agreement with US on air cargo. Limited Open Skies Agreement with Brunei, Indonesia and Malaysia under the BIMP-EAGA Agreement	Member of Multilateral Agreement on the Liberalization of International Air Transport. Many liberal or Open Skies bilateral agreements.	94 ASAs. Limited Open Skies Agreement with Indonesia and Malaysia covering IMT Growth Triangle. Thailand has liberal capacity arrangements with its major ASEAN bilateral partners Malaysia and Singapore. Thai has 5th freedom rights to operate Singapore-Jakarta once a day.	56 ASAs. **Strongly supports the CLMV Open Skies agreement. Supports opening up of gateways like Da Nang and Hanoi to unlimited 3rd and 4th freedom. Limited 5th freedom traffic rights granted to Singapore and Thailand. Granted limited 5th freedom traffic rights to some non-ASEAN carriers**
INTERNATIONAL AVIATION: MULTIPLE DESIGNATION									
Double or multiple designation based on reciprocity	…	Most agreements allow for multiple designation	Existing ASAs reflect socialist	Government allocates traffic rights on a 'first	Of the 45 ASAs, two provide for double	E.O. 219 requires that 'at least two international	Singapore is receptive to multiple	…	Vietnam has adopted a multiple designation policy

BRUNEI DARUSSALAM	CAMBODIA	INDONESIA	LAOS	MALAYSIA	MYANMAR	PHILIPPINES	SINGAPORE	THAILAND	VIETNAM
			linkages of past.	come first served' basis to capable applicants. Malaysia supports multiple designation policy.	designation, four for multiple designation, the remainder being single designation. Thailand and China both have two carriers operating to Myanmar	carriers shall be designated official carrier(s) for the Philippines.' Supports multiple designation policy in international routes	designation		
INTERNATIONAL AVIATION: MULTIPLE GATEWAYS									
Brunei International Airport is sole gateway	Multiple gateway access	Most agreements grant separate traffic rights to gateways such as Denpasar (Bali). Indonesia does not provide any incentives to service secondary gateways.	…	Aircraft from nations signing Open Skies Agreements with Malaysia are free to operate into any or all of the country's six international airports.	Allows multiple gateway access to Yangon and Mandalay	95% of international traffic is handled by Ninoy Aquino International Airport. The Administration aims to develop Manila, Cebu, Davao, Clark, Subic and Laoag as tourism hubs. In general foreign airlines are free to operate into any of the gateways. Some agreements provide for separate traffic rights to secondary gateways.	Changi Airport is the sole gateway	Thailand seeks to attract foreign carriers to its secondary gateways, especially Phuket	Gives priority to ASEAN partners in opening up gateways outside of HCM City and Hanoi.
INTERNATIONAL AVIATION: AIRLINE COOPERATIVE AGREEMENTS									
Recent agreements allow airline cooperative arrangements, including code sharing. Brunei has code sharing agreements with Thailand and Malaysia.	…	Indonesia allows code sharing agreements by its carriers with foreign carriers	…	Malaysia allows code sharing agreements. Malaysian Airlines codeshares with PAL. It signed an MOU with Garuda to operate 3rd country code	Myanmar allows code sharing (Myanmar International Airways has a code sharing arrangement with Thai Airways)	Philippines allows code sharing agreements. PAL code shares with Malaysian Airlines, Garuda and Vietnam Air and some non-ASEAN carriers.	Singapore Airlines is a member of the Star Alliance.	Thai Airways is a member of the Star Alliance and has a number of code sharing arrangements.	Vietnam has been amending the various MOU to include airline cooperative agreements (past agreements did not allow code sharing). Most of the agreements with ASEAN allow for

BRUNEI DARUSSALAM	CAMBODIA	INDONESIA	LAOS	MALAYSIA	MYANMAR	PHILIPPINES	SINGAPORE	THAILAND	VIETNAM
				sharing services to Australia, Germany and the UK.					code sharing of 3rd and 4th freedom traffic only. The agreement with Singapore allows for 3rd country code sharing. Outside of ASEAN, it allows for 3rd country code sharing in its agreements with countries like Hong Kong, Australia, USA, Germany, etc.
INTERNATIONAL AVIATION: CHARTER POLICY									
In general, Brunei adopts a liberal policy towards charter services, which are viewed as supplementary to the carriage of passengers and freight to meet seasonal or temporary needs that cannot be met by scheduled services	…	Indonesia liberalized charter rules in 1996. All gateways have been opened up for charter operators. The government has licensed 70 charter operators (35 of these are operational)	….	Malaysia has a liberal charter policy, readily approving charter applications.	…	E.O. 219 states that 'The Civil Aeronautics Board may authorize chartered flights and non-scheduled services provided the traffic of the scheduled services shall not be significantly diverted.' The Philippines views charters as a way of supplementing scheduled flights, especially to provincial tourist destinations. In general, the Philippines has a liberal approach to charter flights.	Singapore has a moderately liberal approach to air charters, though these are not used extensively at the moment. Approvals of charters which do not compete with scheduled services can be obtained relatively readily, though the approval process is not necessarily speedy.	Thailand grants unlimited access to all locations in Thailand.	The government allows charter operations (especially to tourist destinations) to supplement (and not compete with) scheduled flights.
INTERNATIONAL AVIATION: AIR FREIGHT POLICY									
Brunei has adopted a relatively liberal approach to air freight. Dedicated air	NA	Indonesia has adopted a relatively liberal policy. Local	Laos has yet to ratify the ASEAN MOU on Air	Malaysia has signed bilateral open skies cargo agreements with	NA	In general, the Philippines has adopted a relatively liberal stance on air	Singapore has a liberal policy towards air freight, e.g. the	Thailand has an open approach to air cargo	Vietnam supports the ASEAN MOU on Air Freight Services and seeks to

BRUNEI DARUSSALAM	CAMBODIA	INDONESIA	LAOS	MALAYSIA	MYANMAR	PHILIPPINES	SINGAPORE	THAILAND	VIETNAM
freight services are allowed. Brunei has yet to ratify the ASEAN MOU on Air Freight Services.		freight forwarders are concerned about the integrators which are said to have taken business away from local freight forwarders.	Freight Services.	Germany and the Netherlands.		freight. Unlimited traffic rights (up to 5th freedom) were granted under the 1995 MOU between the Philippines and the US. It supports the ASEAN MOU on Air Freight Services	recent ASA between Singapore and Australia fully liberalises air cargo operations, allowing carriers from both countries unrestricted cargo rights to, from and beyond the other country.		develop the MOU into a multilateral agreement.
DOMESTIC AVIATION									
Not relevant	There are limited domestic aviation services in Cambodia.	Domestic aviation was deregulated in 1998. Deregulation was followed by new entry (see below).	Domestic services within Laos are operated by Lao Airlines.	Malaysia Airlines, Air Asia (a no frills carrier) and Jaya Air operate domestic services	Domestic airline services operated by Myanmar Airways, Yangon Airways and Mandalay Airlines.	Entry and exit is guided by aviation policy set out in E.O. 219 which mandates progressive liberalization of domestic aviation. Foreign participation limited by the 60:40 Constitutional provision	Not relevant	Thailand allows open access on all routes, permitting private carriers to compete directly with Thai Airways.	Domestic operations by Vietnam Airlines and Pacific Airlines.
NATIONAL CARRIER									
Royal Brunei Airlines, the wholly government owned national carrier established in 1974, provides scheduled flights to 23 destinations in Asia, Middle East, Europe and Australasia. Brunei.	No operating national carrier. Royal Air Cambodge, the state owned national carrier, ceased operations in November 2000.	Garuda Indonesian Airways became a fully state owned airline in 1954. Merpati is a fully owned subsidiary. Garuda was reorganized in 1998, following the Asian Financial Crisis.	Lao Airlines (formerly Lao Aviation), the government owned national carrier, operates domestic and (limited) international services with its fleet of 6	Malaysia Airlines has developed extensive route networks of domestic and international services. The airline has incurred losses over the past five years, largely due to loss-producing	Government owns and operates domestic carrier Myanmar Airlines. In turn, Myanmar Airlines holds 51% of shares in domestic operators Yangon Airways and Mandalay	Philippine Airlines (PAL), formed 1942, was privatized in 1992. Following the Asian Financial Crisis, PAL was declared bankrupt and forced into rehabilitation. PAL continues to be the dominant Philippine Flag Carrier in both	Singapore Airlines quoted on stock exchange, but majority holding (56.83%) is by the Government owned holding company Temasek Holdings. There are no proposals to alter the	Thai Airways is majority (92%) owned by government. There are plans to privatize an additional 30% of the company in the near future. Thai Airways operates both domestic and	Vietnam Airlines Corporation is a government owned corporation with responsibility for three air transport business: Vietnam Airlines, Pacific Airlines and Vietnam Air Service Company.

BRUNEI DARUSSALAM	CAMBODIA	INDONESIA	LAOS	MALAYSIA	MYANMAR	PHILIPPINES	SINGAPORE	THAILAND	VIETNAM
		There are plans to privatize Garuda in the near future.	aircraft.	domestic routes. In January 2002, a Restructuring Committee was appointed. Malaysia Airlines is currently rationalizing its route structure.	Airlines. State owned Myanmar International Airways operates a single aircraft to Singapore, Kuala Lumpur and Bangkok.	domestic and international routes.	ownership structure in the immediate future. Singapore Airlines is the 100% owner of SilkAir, a short haul regional operator.	international services.	
OWNERSHIP AND CONTROL									
An airline registered in Brunei Darussalam must be substantially owned and effectively controlled by Brunei Darussalam interests.		Scheduled domestic air services are open to new carriers. Foreign operators must form joint ventures. Maximum permitted equity is 49%.	…..	Ownership rules of 51:49 in favour of Malaysian nationals apply.	Strong belief in state control.	Foreigners may invest in Philippine owned airlines to the extent of the Constitutional provision providing for 60:40 ownership by Filipinos and effective Filipino management and control.	The Government of Singapore would be happy to move to a 'principal place of business' ownership criteria, although it recognizes that this would pose problems given that many of its ASAs specify a 'Substantial Ownership'	Ownership and control is a live issue in Thailand, as the state owned carrier Thai Airways is not supportive of a 'principal place of business' test. Thai Airways favours further privatization up to a limit of 49% foreign ownership.	Vietnam operates a 51:49 ownership and control rule in favour of local ownership. The Government recognizes the need to develop ownership rules in compliance with ICAO's recommendations.
PRIVATE OPERATORS									
Royal Brunei Airlines is the sole operator.	President Airlines and Royal Phnom Penh Airways operate old aircraft types and have limited route structures. Siem Reap Airways appears to be a subsidiary of the Thai carrier Bangkok Airways	Whereas there were only five Indonesian carriers in 1997 (Garuda, Merpati, Sempati, Mandala and Bouraq), deregulation of the industry in 1998 led to a number of new entrants, including Batavia	International services to/from Laos are dominated by foreign (especially Thai) carriers. Lao-owned operators Lao Flying Service and Euro-Asian Aviation plan	Two private operators – Air Asia (a no frills carrier) and Jaya Air - compete with the government owned Malaysia Airlines for passenger traffic. Air Asia, which is aggressively developing domestic routes,	There are no privately owned Myanmar operators.	Cebu Pacific operates regional flights to Hong Kong and South Korea. Air Philippines (an affiliate company of PAL) concentrates on the domestic market, but mounts charter flights to Brunei and Indonesia. Asian Spirit and Southeast Asian	Currently, Singapore Airlines and its subsidiary SilkAir are the only airlines currently based in Singapore. There is a great deal of interest in setting up one or more low cost carriers.	Thai Government policy is supportive of private sector initiatives. Private carriers may compete domestically and use international traffic rights not used by Thai Airways. Private sector carriers include	There are no privately owned Vietnamese carriers.

BRUNEI DARUSSALAM	CAMBODIA	INDONESIA	LAOS	MALAYSIA	MYANMAR	PHILIPPINES	SINGAPORE	THAILAND	VIETNAM
		Air and Lion Airlines. To date, thirty operators have been granted licenses to operate scheduled flights, although only 17 are operational.	to offer domestic services.	also plans to expand into regional routes, including Xiamen and Hong Kong. Transmile Air is a specialized air cargo operator.		Airlines concentrate on tertiary routes.		Andaman Air, Bangkok Airways, Orient Thai, PB Air and Phuket Air.	
INFRASTRUCTURE: POLICY AND LIMITATIONS									
Capacity of Brunei International Airport approx 2.2 million passengers per year. While current traffic of 1.3 million is below rated capacity, BIA has plans for future growth.	Runway width and length at Phnom Penh prohibit landings by B747, B777 and A330.	Deficiencies in some regional airports, e.g. inability to accommodate larger aircraft types at Pontianak, inadequate terminal facilities at Medan.	Close control of Lao Airlines by Government inhibits choice of aircraft types.	There are no significant economic or physical infrastructure constraints.The Government aims to improve the efficiency and performance of Kuala Lumpur International Airport (KLIA) to enhance its claims for hub status. The other gateways will act as feeder airports to complement the KLIA hub.	Industry suffers from lack of investment. Yangon International Airport limited to B763 and AB6 short haul operations.	Whilst there are no slot or runway restrictions at Manila's Ninoy Aquino International Airport, the airport is constrained by lack of facilities for transit and transfer passengers. Opening of Terminal 3 delayed. Secondary gateways like Mactan Cebu and Subic still underutilized. Investments needed to expand terminal capacities in others like Clark.	Government active in ensuring adequacy of aviation infrastructure. While Changi Airport currently has adequate capacity, further expansion is planned. A new terminal is being built and there is provision for a new runway to be built within the next decade.	Government plans to expedite construction of Surarnbhumi Airport, due to open in 2005. Similarly, Government support for expansion of regional airports.	Terminal and car parking at Than Son Nhat Airport (Ho Chi Minh City) already congested. Airlines experiencing difficulty in obtaining slots. Noi Bai Airport (Hanoi) is being expanded to accommodate 6.5 million passengers per year. Vietnam lacks facilities for the overhaul of jet aircraft.

Source: Country case studies (see Volume Two)

4.2.3. Multiple Designation

Bilateral agreements of the 1950s and 1960s typically designated a single airline from each country to serve a given route. In contrast, liberalized ASAs permit several designated airlines to serve a given route or drop restrictions on the number of airlines permitted to serve the route in question.

A number of ASEAN countries already allow multiple designation in at least some of their ASAs (see Table 4-1). For example, Brunei Darussalam allows either double or multiple designation where the other party agrees to reciprocal rights. Similarly, most active Indonesian ASAs allow for multiple designation and Vietnam has adopted a policy of multiple designation. In the Philippines, Executive Order No. 219 (1995) lays down that at least two international carriers shall be designated official carriers.

4.2.4. Multiple Gateways

Early bilateral air services agreements usually specified which gateways or airports had to be used by airlines operating international routes. Recent liberalized ASAs permit airlines to choose which gateways they wish to use. However, we note that countries adopting a more liberal gateway policy may impose restrictions on certain airports because of environmental concerns or because the airport in question has capacity limitations.

We note that a number of ASEAN countries operate various forms of multiple gateway policy (see Table 4-1). For example, most Indonesian ASAs grant separate traffic rights to gateways such as Denpasar (Bali), while airlines from nations signing open skies agreements with Malaysia are free to operate into any or all of the country's six international gateways. Myanmar allows multiple gateway access to Yangon and Mandalay. Multiple gateway issues are not relevant in the case of Brunei Darussalam and Singapore.

Several ASEAN countries wish to encourage foreign airlines to serve secondary gateways in order to encourage tourist traffic. For example, the current administration in the Philippines seeks to encourage foreign airlines to call at Cebu and Davao in order to develop tourism. However, traffic rights granted to foreign airlines to operate services to regional centres count as part of those airlines overall traffic rights to the Philippines, making such calls less attractive. In this context, we note that 95% of international traffic is handled by Manila's Ninoy Aquino International Airport. Thailand and Vietnam also seek to attract foreign airlines to their secondary gateways.

4.2.5. Airline Cooperative Agreements

For some years airlines have been attempting to consolidate in order to achieve better financial results. Airline mergers have been mooted, but have frequently been rejected by competition policy regulators. Airlines have also sought to share facilities and build bigger networks to offer better services and reduce costs. Internationally, airlines often cooperate within alliances of varying scope and depth. Code sharing, the selling by one airline of seats on services offered by another airline, allow airlines to offer improved service as well as contain costs through economies of scale and scope. They are also a response to restrictions on market access, notably restrictions on route access, on foreign ownership and control. Airline alliances, code sharing and similar competitive responses usually require regulatory approval.

In general, ASEAN countries have adopted permissive policies regarding airline alliances (see Table 4-1). Singapore Airlines and Thai Airways are members of the Star Alliance. Brunei Darussalam's recent ASAs allow airline cooperative arrangements, including code sharing. Malaysia and Indonesia have approved Malaysia Airways and Garuda's 3rd country code sharing services to Australia, Germany and the UK. Myanmar permits code sharing.

4.2.6. Charter Policy

In general, ASEAN countries have adopted a relatively liberal stance in relation to charter operations for passengers and freight (see Table 4-1). For example, Brunei Darussalam views charter operations as valuable in meeting seasonal or temporary demand for the carriage of passengers and freight that cannot be met by scheduled services. Malaysia, Thailand and Vietnam have also adopted a relatively liberal stance to charter operations.

Whilst Singapore has a moderately liberal approach to air charters, we note that charters are not used very frequently at present. Approvals of charters which do not compete with scheduled services may be obtained relatively readily, though the approval process is not necessarily speedy. Similarly, the charter policy adopted by the Philippines recognizes that such flights may divert traffic away from scheduled operators. Executive Order 219 (1995) states in part that 'The Civil Aeronautics Board may authorize charter flights and non-scheduled services *provided the traffic of the scheduled services shall not be significantly diverted'* (emphasis ours).

4.2.7. Air Freight Policy

In general, ASEAN countries have adopted a relatively liberal stance towards air freight (see Table 4-1). We note that the ASEAN MOU on Air Freight Services, the first step towards the full liberalization of air freight services in the ASEAN region, has yet to be ratified by some members. When ratified, the MOU will allow the designated airlines of each member country to operate all-cargo services up to a limit of 100 tons weekly to 20 designated ASEAN airports.

Currently the majority of ASEAN members have adopted a relatively liberal air freight policy. Brunei Darussalam, which has yet to ratify the MOU, permits dedicated air freight services. Malaysia has signed bilateral Open Skies cargo agreements with Germany and the Netherlands. The Philippines which supports the MOU has granted unlimited traffic rights (up to 5th freedom) under the 1995 agreement with the US. Vietnam likewise supports the MOU on Air Freight Services and seeks to develop it into a multilateral agreement.

4.3. The Aviation Industry in The ASEAN Countries

4.3.1. Background

The nature and sophistication of aviation industries varies considerably across ASEAN member states. It is instructive to contrast the nature of the industry in Singapore with that in Cambodia. Singapore has adopted a relatively liberal aviation policy, a large number of ASAs – including a number of relatively liberal Open Skies agreements - and has become one of the two major aviation hubs in the ASEAN region. It has an extensive network of services around the region and a wide array of connections with the rest of the world. Changi Airport is served by many ASEAN and non-ASEAN carriers. Singapore has ensured that its aviation related infrastructure is modern and efficient. Given the nation's relatively high per capita income (US$20,000+), Singapore residents enjoy high discretionary incomes, some part of which may be spent on airline travel. Singapore Airlines, the largest ASEAN airline and one of the 20 largest in the world, has benefited from the country's liberal policy.

In contrast, Cambodia – with per capita income of US$285 - has a small aviation sector and relatively few active bilateral air service agreements. Cambodia has no national carrier, Royal Air Cambodge – the former state-owned national carrier – ceased operations in November 2000. Several airlines, including Mekong Airlines, have commenced services but been unable to sustain them. The remaining carriers – President Airlines and Royal Phnom Penh Airways – operate old aircraft types and have limited route networks. Foreign carriers dominate the limited range of international air services operating to and from Cambodia.

The contrast is not made to point out any deficiencies in individual ASEAN members, but to emphasize that ASEAN embraces countries at very different stages of aviation development. The development of ASEAN airline policy must necessarily accommodate such differences.

4.3.2. Domestic Aviation

Some Open Skies Agreements permit airlines from other countries to operate domestic services. For example, under current arrangements a New Zealand carrier is permitted to fly domestic services in Australia. However, many Open Skies agreement do not free up domestic aviation markets. The issue of access to domestic aviation markets of member countries could become an important issue if ASEAN moves towards a single aviation market. Since the abolition of cabotage is not essential to a negotiated open skies package we have chosen not to deal with the issues in depth in this study.

In general, the domestic aviation markets of ASEAN countries are reserved for airlines domiciled in the home state. We note that several ASEAN countries have deregulated domestic aviation. For example, Indonesia deregulated domestic aviation in 1998. Since then the sector has attracted a number of new entrants (see Table 4-1). Similarly, Thailand allows open access on all domestic routes, allowing private carriers to compete with Thai Airways. The Philippines has also liberalized its domestic aviation market. Entry and exit is subject to policy laid out in Executive Order 219 (1995). EO 219 envisages the progressive liberalization of the aviation industry in general.

Foreign investors are able to invest in domestic aviation in certain ASEAN countries. For example, foreign participation is allowed in the Philippines, but is limited by the 60% domestic, 40% foreign participation Constitutional provision.

4.3.3. Intra-ASEAN Air Services

The relative importance of intra-ASEAN air traffic (as a proportion of total airline traffic) varies as between ASEAN member countries.[7] For example, intra-ASEAN traffic accounts for 51% of total traffic in the case of Brunei Darussalam. Intra-ASEAN traffic accounts for 60% of total traffic at Jakarta's Soekarna-Hatta Airport and 40% at Malaysia Kuala Lumpur International Airport.

Not surprisingly, many ASEAN airports report that Intra-ASEAN sectors are amongst the most heavily trafficked. For example, the Brunei – Singapore – Brunei (21.7% of total traffic) and Brunei – Kuala Lumpur – Brunei (9.5%) routes are the densest routes serviced by Brunei International Airport. Similarly, the top three ASEAN sectors ex KLIA (KUL-SIN-KUL with almost 2 million passengers in 2002; KUL-BKK-KUL, 774,000; and KUL-JKT-KUL, 544,000) rank among the most highly trafficked routes.

4.3.4. National Carriers

National carriers play significant role in the aviation industries of most ASEAN countries (see Table 4-1). The largest of the ASEAN national carriers - Singapore Airlines, Thai Airways, Malaysia Airlines – not only operate domestic services (with the obvious exception of Singapore) and intra-ASEAN services but also operate extensive networks linking Asian ports to Europe, Middle East, North America and Australasia.

Singapore Airlines is the largest airline in ASEAN and one of the top 20 airlines in the world. It has grown rapidly over a long period, and has been consistently profitable. While Singapore Airlines is quoted on the Stock Exchange, it is majority owned (56.83%) by the

[7] Differences in definition and coverage of official statistics mean that it is not possible to present a complete picture of intra-ASEAN airline traffic.

Singapore Government operating through Temasek Holdings. There are no current proposals for further privatization. Thai Airways is also majority (92%) owned by government, although there are plans to privatize an additional 30% of the company in the near future. Thai Airways operates domestic, intra-ASEAN and other international services.

Some ASEAN national carriers experienced difficulty following the Asian Financial Crisis. For example, Garuda Indonesian Airways was re-organized in 1998 and there are plans to privatize Garuda in the near future. The Philippines national carrier, Philippine Airlines (PAL), was privatized in 1992. However, following the Asian Financial Crisis PAL was declared bankrupt and forced into reconstruction.

Royal Brunei Airlines is an independent corporation wholly owned by the government of Brunei Darussalam. Similarly, Vietnam Airlines Corporation is a government owned corporation with responsibility for three air transport businesses: Vietnam Airlines, Pacific Airlines, and Vietnam Air Service Company.

Government ownership is firmly entrenched in Laos and Myanmar. Lao Airlines is tightly controlled by the Lao Government. In Myanmar, the government owns and operates the domestic carrier Myanmar Airlines as well as the single aircraft Myanmar International Airlines. In turn, Myanmar Airlines holds 51% of shares in domestic carriers Yangon Airways and Mandalay Airlines. Cambodia has no operating national carrier. Royal Air Cambodge, the state owned national carrier, ceased operations in November 2000. Foreign carriers dominate Cambodia's international air services.

Many ASAs specify that airlines other than those owned by nationals of the countries that are parties to the agreement are not permitted to offer services on all or some routes. Hence, the nationality of an airline assumes great importance and the concept of national ownership must be defined. In many cases the definition is couched in terms of beneficial ownership and/or effective control of the airline in question. However, there is a tendency to replace the concept of beneficial ownership with a 'principal place of business' test.

ASEAN countries differ in their policy regarding ownership and control. For example, an airline registered in Brunei Darussalam must be substantially owned and effectively controlled by Brunei interests. While Malaysia and the Philippines allow foreigners to invest in airlines, controlling interest is vested in nationals of the relevant country: Malaysian ownership rules reserve 51% ownership for Malaysian nationals while the Philippine Constitution provides for 60% ownership by Filipinos and effective Filipino management and control. In contrast, Singapore favors more liberal rules and would like to move to a 'principal place of business' criteria, although the Singapore Government recognizes that this would pose problems given that many of its ASAs specify 'substantial ownership'.

4.3.5. Private Sector Carriers

Privately owned airlines compete with government owned airlines in a number of ASEAN countries, primarily on domestic and intra-ASEAN routes (see Table 4-1). For example, two private operators – Air Asia and Jaya Air – compete with the government owned Malaysia Airlines in the Malaysian domestic market. Air Asia, which is aggressively developing domestic routes, also plans to offer services to regional destinations such as Xiamen and Hong Kong. Similarly, Cebu Pacific, Asian Spirit and Southeast Asian Airlines compete with PAL in the Philippine domestic market, while Andaman Airways, Bangkok Airways, Orient Air, PB Air and Phuket Air compete with Thai Airways. Bangkok Air is active on routes to neighbouring ASEAN countries.

We note that Royal Brunei Airlines is the sole operator in Brunei Darussalam and that the government owned Singapore Airlines and its subsidiary SilkAir are the only airlines currently based in Singapore. There are no privately owned airlines operating in Myanmar or Vietnam.

4.3.6. Low Cost Carriers

Low cost carriers (LCCs) have had a major impact on airline competition in the US, Europe, and in other areas. As noted elsewhere in this report, it is likely that an Open Skies environment, embodying liberal rules on designation, the abandonment of capacity and fare regulation, and the adoption of seventh freedom traffic rights, would lead to the rapid growth of ASEAN LCCs. In turn, this boom would have a major impact on the industry. It might well turn out that the primary mechanism through which Open Sky impacts on aviation is through LCCs - competition from this source might have more far reaching effects than competition from existing carriers operating more competitively, or on more routes.

LCCs already operate, albeit in a limited way, in the ASEAN region. The best known carrier is the Malaysian airline, AirAsia, though there are other start ups in other ASEAN countries, especially Indonesia. The scope for LCCs to operate in ASEAN is limited: they can operate only in deregulated domestic markets, notably in Malaysia, and on specific liberalised international routes. We note that there is a great deal of interest at the moment in the possibility of setting up a low cost carrier in Singapore and there would appear to be room to do so in Thailand.

4.3.7. Air Fares

Table 4-2 compares air fares and yields (per nautical mile) for a sample of intra-ASEAN routes. A notable feature is the variation in yield per nautical mile – from 9 to 48 US Cents per nautical mile. In general, as we would expect, the yield per nautical mile is higher on shorter routes, reflecting the high proportion of terminal costs on short routes. Similarly, the yield per nautical mile is generally higher on thinly trafficked routes. This may reflect lower load factors and/or lower levels of competition.

Table 4-3 suggests that air fares to and from Singapore and Manila tend to be lower than those to and from other ASEAN capitals. The low fares may be a product of the greater traffic density to/from Singapore. They may also reflect the intensity of competition on these routes.

TABLE 4-3: COMPARISON OF INTRA-ASEAN AIR FARES AND YIELDS PER NAUTICAL MILE

Route	Distance (NM)	Return Excursion Fare (US$)		U.S. Cents per NM	
		Lowest	National Carrier	Lowest	National Carrier
Bangkok (BKK) to:					
Hanoi	524	230	379	21.95	36.16
Jakarta	1,255	606	606	24.14.	24.14
Kuala Lumpur	651	384	384	29.49	29.49
Manila	1,188	346	363	14.56	15.28
Phnom Penh	286	273	273	47.73	47.73
Vientiane	269	200	210	37.10	39.00
Yangon	313	251	251	40.10	40.10
Hanoi (HAN) to:					
Bangkok	524	399	-	38.07	-
Kuala Lumpur	1,135	515	515	22.69	22.69
Singapore	1,185	866	-	36.54	-
Vientiane	262	200	200	38.17	38.17
Kuala Lumpur (KUL) to:					
Bangkok	674	385	-	28.56	-
Hanoi	1,135	476	476	20.97	20.97
Jakarta	623	139	-	11.16	-
Manila	1,345	476	476	17.70	17.70
Phnom Penh	562	282	-	25.09	-
Singapore	160	112	112	35.00	35.00
Yangon	911	545	-	29.91	-
Manila (MNL) to:					
Bangkok	1,188	260	260	10.94	10.94
Jakarta	1,504	298	298	9.91	9.91
Kuala Lumpur	1,345	486	521	18.07	19.37
Singapore	1,281	298	298	11.65	11.65
Singapore (SIN) to:					
Bangkok	779	SG$165	SG$262	6.06	9.62
Hanoi	1,185	SG$439	SG$439	10.60	10.60
Kuala Lumpur	180	SG$209	SG$304	33.22	48.31
Manila	1,281	SG$418	SG$418	9.34	9.34
Phnom Penh	615	SG$554	SG$610	25.77	28.31

Source: Country Case Studies (see Volume Two)

4.3.8. Infrastructure

Airlines depend on services supplied by various types of infrastructure, both aviation related and non-aviation related. For example, airlines are consumers of non-aviation related infrastructure such as electricity and telecommunications. Airlines now rely heavily on telecommunications for their information systems and to market and conduct operations. The competitiveness of airlines with weak economic infrastructure will be poor.

We note that aviation related infrastructure may act as a constraint on aviation development: For example, the availability of airport infrastructure is frequently a constraint on the development of air transport. This can especially be the case where air traffic is rapidly growing, as it is in several of the ASEAN countries. The use of preferred airports may have to be rationed, and air transport policies often seek to divert traffic to less busy airports.

Aviation infrastructure poses few problems in Singapore and Malaysia (see Table 4-1). Singapore is noted for the quality of its infrastructure. While Changi Airport has adequate capacity at the moment, further expansion is planned. A new terminal is being built and there are plans to build a new runway within the next decade. Similarly, there are no significant physical or economic infrastructure constraints in Malaysia, although the Government aims to improve the efficiency of Kuala Lumpur International Airport (KLIA) in a bid to enhance its claims for hub status.

However, in other ASEAN countries aviation related infrastructure undoubtedly acts as a constraint on the development of air services. For example, some Indonesian regional airports are unable to accommodate aircraft types operated by foreign airlines (e.g. Pontianak) while others have inadequate terminal facilities (e.g. Medan). Similarly, the Ninoy Aquino International Airport in Manila is constrained by lack of facilities for transit and transfer passengers, in part due to delays in opening the recently constructed Terminal 3. Investment is required at secondary gateways such as Clark and Laoag.

Runway length and/or width may be also constrain air services. Yangon's international airport is limited to B763/AB6 short haul operations. Whilst this is not a serious constraint at present, were the Myanmar economy to be opened up to tourism, runway limitations could pose a serious constraint. Runway width limitations at Phnom Penh prevent landings by B777 and A320 aircraft.

Similarly, a shortage of skilled management and labour may constrain aviation industry growth. Airline operations rely on the presence of a range of highly skilled types of labour. In some countries, these skills (e.g. IT skills) may be in short supply. In particular, management skills and experience of managers in the airline industry may not be readily available. This will hinder the development of their airlines. These skills can be obtained from hiring staff from other countries, though this can be expensive and it can erode the competitive base of the airlines.

A scarcity of risk finance for private airlines may also constrain airline growth. Privately owned airlines need finance, and given the profit records of many airlines in the world, airlines are often seen as risky. Therefore, lenders may not be willing to lend to airlines, or if they do, they may demand a high risk premium. Airlines that have experienced low profitability recently, or that are relatively new and have not had an opportunity to establish a sound track record, may find it difficult to obtain risk finance for expansion.

Airline viability may be an issue: it is normally handled by the designating state. It is difficult for a state to refuse a designation by another state on the grounds of lack of financial viability. Many countries have imposed bonding requirements on charter operators, however in a liberalised environment the distinction between scheduled and charter operators is removed and bonds are not applied. Of course, financial viability of carriers and consumer protection issues are linked. It may be that Asean states could agree among themselves on a bonding scheme for new entrant carriers in order to provide the desired level of consumer protection if it is felt that there is an unacceptable level of risk of financial failure resulting in financial loss to consumer. There are of course other regulatory issues, some, such as air safety and licensing, are aviation specific, whilst others such as environmental protection are more broadly applicable within a society.

This report notes the need for such regulation but does not address the application of such regulation in the context of an Asean ‘Open Sky’. Chapter 11 includes proposals for further study of a number of issues, including competition policy.

5. ASSESSING THE SCOPE FOR GAINS FROM LIBERALISATION

5.1 Introduction

A movement to Open Sky in the ASEAN region should not just be seen as a policy to be advocated regardless of its effects. Open Sky has the potential to create economic and other benefits for the member countries. In implementing the various policy stages towards Open Sky, it helps if the rationale for the policy is well understood. In this chapter, the rationale for, and benefits from, Open Sky are outlined. In the next section, the basic rationale for Open Sky is analysed. Then, the possible gains from it are considered by looking at patterns of air fares in the ASEAN regions- this is a practical way of seeing whether there are likely to be gains made. One catalyst for enhancing competition and creating gains could well be the growth of low cost carriers, and in the following section, the experience of these, and how they impact on the air transport industry, are considered.

5.2 The Rationale for Open Sky

When two or more countries move towards Open Sky, they open up the possibility of gains from two sources. These are trade and competition.

Gains from trade come about when one country is able to provide goods and services to another below the cost which its own industries have been able to supply them. They are the result of a high cost supplier being replaced by a lower cost supplier. Potentially, both the supplier country and the buying country can gain.

In the airline case, Open Sky leads to greater scope for airlines to serve a city pair market on the basis of their ability to supply rather than on the basis of which country they come from. If capacity controls between two countries are relaxed, the airlines which can achieve the lowest costs will gain a greater market share, and overall costs will fall. When airlines from third countries are allowed to serve city pair routes, those with lower costs will enter, and overall costs will fall. Users of the airlines will gain, and the airline which gains improved access will also gain. As an example, Australia has gained from allowing airlines from ASEAN to carry its passengers to Europe on a 6th freedom basis, and those airlines have also gained from increased market access.

The other mechanism through which Open Sky will create benefits is competition. Increased competition between firms puts pressure on them to reduce prices to consumers, and to reduce their costs to efficient levels.

In the airline case, Open Sky leads to city pair markets being more open to new competitors, and it also leads to existing competitors having more scope to compete. If the capacity which two airlines have on a route is already determined, they have little scope to compete, since no matter how good they are or how low their prices are, they cannot get a larger market share. When additional airlines are allowed on to a route, they put pressure on to the existing airlines to perform; by being efficient and lowering fares, and by offering a better deal to travellers. Competition means that higher cost airlines are not able to survive unless they are able to lower their costs or offer a superior product for which the consumer of air travel is willing to pay.

Ultimately, many of the gains from competition come from lower costs. If competition merely resulted in fares for a particular class of travel falling, with no cost reduction, the gain to travellers would be more or less matched by the reduction in profits to the airlines. When costs are reduced, there is an overall gain.

There is another source of gain which comes from opening up markets to more competition (and to an extent trade). This is from innovation and providing more of the products which consumers want.

In the air transport markets, often the main source of benefit from opening up has come from making products available which were previously unavailable. In particular, liberalisation, both in domestic and international markets, has resulted in much greater availability of lower fares. These are often more restricted, and on a no frills basis, but they are what the travellers want. When markets are not competitive, airlines tend to be conservative in the range of fares they offer, and concentrate on supplying the higher fare markets- they ignore travellers who want low fares and are prepared to accept a less convenient product. They are not under pressure to serve all markets. Thus, when markets are liberalised, low cost carriers enter and make a large impact. A major source of gain from opening up markets, in the US, Canadian and Australian domestic markets, and in international markets in Europe, has been from low cost travel becoming available.

The main benefits and costs from opening up markets to trade and competition will be experienced by the two groups most directly affected- the consumers and the producers. In the aviation case, these will be the travellers and the airlines. The sharing of the benefits will depend on how intense the competition is. If competition is weak after markets open up, airlines will be the main gainers- airlines will enjoy greater market access and lower costs and they will be able to convert these into higher profits. If competition is strong, travellers will be the main gainers, and they will enjoy lower fares and improved product availability.

Overall, more competition and trade will lead to net gains in most cases. However the distribution of these gains can differ, and sometimes one group loses out. Thus airlines can lose out from facing more competition- but the losses they face are less than the gains which are enjoyed by their passengers.

As noted above, the main form of the gains from liberalisation are reduced costs of operation and improved product availability. Most of these gains accrue to passengers and other customers of the airlines (in the case of freight), and to the airlines. There are a number of other groups which gain indirectly.

These include:

- Tourism industry benefits- more travel will lead to changes in tourism, and this creates benefits and costs for the industry itself, and for the nation as a whole.
- Government revenues effects- governments levy taxes and provide subsidies, and changes in air transport and tourism activity will impact on government revenues.
- Foreign exchange effects- earnings of foreign exchange may be affected by liberalisation of aviation; this may give rise to benefits or costs depending on the circumstances.
- Employment- liberalisation affects employment levels.
- Skill development- through affecting the demand for skilled workers in the airline and tourism industries, liberalisation can affect skill development.
- Risks- by opening up markets, liberalisation can increase the risks faced by firms such as airlines.
- Industry communication and development- improved travel assists industry communication and increases the degree of integration of the regions economies.

In addition to these economic impacts, liberalisation can also impact on defence and security, health and safety, the environment, and on foreign relationships.

These effects are considered in greater detail in Chapter 7.

To understand the impacts of moving to Open Sky for a specific country, it will be necessary to analyse the different policy options, and their effect, one by one. This in turn, makes it possible to assess the impacts of packages of measures.

For example, a move to multiple designation will primarily work through increasing competition. There will be pressure for fares and costs to fall. Travellers will gain, and some airlines will gain, and others lose. Both inbound and outbound tourism can be encouraged. Business communication will be improved. There could be effects on employment, and on foreign exchange.

A move to allow 5th freedom carriers on a route will work through increasing competition and trade. Lower cost airlines will gain market share, and there will be downward pressure on fares. Consumers will gain, as will the new entrant airline, which has expanded its markets. Existing airlines may lose out on traffic. Tourism between the countries is promoted, and business is facilitated.

While increased reliance on competition and trade will create net benefits overall, the position for a specific country will depend on its circumstances and the characteristics of its air transport markets. It will be necessary to determine:

- How much of a share its airlines have in the markets which are being liberalised;
- How large inbound and outbound tourism are, and whether the travellers on the air route are the country's nationals or foreigners;
- What the net impact on economic activity in the country and the net impact on foreign exchange are; and
- How travellers and airlines share the initial gains from liberalisation.

These issues will be analysed in detail in Chapters 7 and 8.

5.3 Productivity and Fares

One way of measuring the possible gains from liberalisation in an airline market is to compare productivity and costs levels in that market with those in other markets, and to compare fare levels. When productivity is low and costs are high, there is evidence that the more competitive environment under Open Sky will bring gains through cost reductions. Where fare levels are high, or fares from city pair to city pair show considerable variation, there is evidence that fares could be reduced. The evidence on productivity and fares in the ASEAN region is limited, but it is summarised here.

5.3.1 Productivity and Cost Competitiveness

There is little information available about productivity and cost competitiveness (measured by unit costs) for most of the airlines in ASEAN. There is good information for the five or six major carriers, but not for other carriers.

In the past, there have been detailed studies which have measured productivity and cost competitiveness for a sample of world airlines and which have included a few ASEAN carriers (e.g. Oum and Yu, 1998). These studies adjust for factors such as stage lengths which can affect costs. These have shown that one ASEAN airline is a very good performer in productivity terms, and that some of the other ASEAN airlines are not as productive, but are cost competitive because they have low labour costs. In recent years, unadjusted unit costs (Cost per Revenue Passenger Kilometre) for the five major carriers which report (Singapore Airlines, Malaysia, Thai Airways International, Garuda and Royal Brunei) indicate similar levels of unit costs. Thus the major airlines are moderate to very good performers in productivity terms.

It is likely that the new low cost carriers in the region are productive and cost competitive. There is little data on other airlines. Given the operating conditions and fare data, it seems likely that some of these are not very productive.

All in all, this information suggests that Open Sky will result in valuable productivity increases and lower costs, though the change overall will be significant rather than spectacular. Some cost reductions in the major carriers, significant cost reductions in other carriers, and greater market penetration by low cost carriers will combine to reduce costs.

5.3.2 Fares

Data on fares on intra ASEAN routes were collected and they are reported in the country reports. It is usually difficult to analyse fares because fare structures differ from region to region, and route to route. Nevertheless, some observations can be made.

Overall levels of fares in ASEAN appear to be comparable with those in the less competitive European markets, but a bit above those in the more competitive markets (e.g. ex UK) and the US domestic market. More dense markets in the other regions partly explain this. Costs per passenger are lower in busy city pair markets than in low density markets (and fares on some ASEAN dense city pair markets are quite low). On the other hand, lower labour costs should enable lower airline unit costs and fares in ASEAN markets.

Fares differ considerably for different routes within the region. There are a number of higher cost routes, especially those to and from the CLMV countries. This can be explained partly by lower market densities, but it may also be explained by limited competition or restrictions on capacity.

In some cases, there are large directional imbalances in fares- i.e. the fare from A to B is much higher than the fare from B to A. These imbalances reflect a lack of competition, and suggest that competition will bring down fares.

The overall pattern of fares in the region is consistent with one of low, competitive fares on some routes, but with limited competition and capacity restrictions holding up fares in other routes. This suggests that a move to Open Sky will result in overall fare levels falling.

5.4 Low Cost Carriers- the Relevance to ASEAN Air Transport

Low cost carriers (LCCs) have been having a major impact on airline competition in the US, Europe, and in other areas. They are operating to a limited extent in the ASEAN region-perhaps the best example of a traditional LCC is the Malaysian airline, AirAsia, though there are some other start ups in other ASEAN countries, especially Indonesia. Currently, the scope for LCCs to operate in ASEAN is quite limited; they can operate in deregulated domestic markets such as those of Indonesia and Malaysia, and on specific liberal international routes. A movement towards Open Sky in the ASEAN region would change all this. Information for this section is drawn form Doganis (2001), Lawton (2002) and Williams (2002).

It is quite possible that an Open Sky environment, embodying liberal rules on designation, no capacity or fare regulation, and possibly, seventh freedom traffic rights, would lead to a boom in LCCs in ASEAN. In turn, this boom would have a major impact on the industry. It might well turn out that the primary mechanism through which Open Sky impacts on aviation is through LCCs - competition from this source might have more far reaching effects than competition from existing carriers operating more competitively, or on more routes.

Given the likely importance of LCCs in an Open Sky environment, it is relevant to raise a number of questions about them- what they are, how they work and what impacts they have.

5.4.1 What are LCCs?

LCCs are now regarded as a distinct type of airline, as distinct from full service carriers (FSCs). There are different terms for them, including “value based airlines”, but the term low cost carriers will be used here. As a type, they have been around for some time- the largest and most prominent LCC, Southwest in the US, has been operating for over three decades. LCCs became major players in the US industry shortly after deregulation in the early 1980s. There were many entrants, though most failed before 1990. Since then, Southwest has prospered, and other LCCs have entered, though there are not as many around as there were in the mid 1980s. Current day LCCs are more careful in the ways they compete- they are less likely to enter damaging price wars. Nevertheless, in total they form a significant bloc, and they are having a large impact on competition within the US, though not on all routes.

Since the liberalisation of aviation in Europe, around the mid 1990s, there has been spectacular growth of LCCs. Initially these such as Ryanair and EasyJet, were based in the UK, but LCCs have been developing elsewhere, such as Germania and Air Berlin in Germany. The LCCs in Europe have very bold expansion plans, and many aircraft on order. LCCs have been emerging in other liberalised markets, such as Australia and Canada.

LCCs offer cheaper, but simpler services than the FSCs, and these are designed to appeal to leisure travellers and cost conscious business travellers. Their networks are not complex, and they do not promote multiple stage journeys (it is possible to make these, but the airlines do not facilitate them- the passenger takes the risk that they will be able to catch the next flight in the schedule, and they may have to re-check their baggage). They operate fleets which usually consist of one type of aircraft, which makes maintenance and scheduling of aircraft simpler and cheaper (though this means they cannot optimise the type for the route). Most LCCs operate on a one class basis, though they may offer extra facilities- for a price- for business travellers who want more. Typically, their in flight service is minimal, and passengers pay for foods and beverages.

Other characteristics of LCCs are less general. Often, though not always, they will use secondary airports. This is partly because such airports offer lower charges than the main metropolitan airports (sometimes local governments subsidise the LCCs to come to their region, to boost tourism). It is also partly because this is a way of avoiding direct competition with strong FSCs, which have a long established market presence. The LCCs also usually make extensive use of the Internet for booking, which saves on marketing expenses and travel agent commissions. Some still advertise heavily, however.

The key characteristic of LCCs is that they offer low fares- typically much lower than those offered by the FSCs which have been serving a route. These fares are not very restrictive (e.g. with overnight stay restrictions), though they are normally not refundable. Fares vary according to availability, and will often rise as the time gets closer to the time of the flight. While very cheap seats will be available on some flights which are not in demand, some fares, on busy flights, will be quite high, though not usually as high as the fares previously offered by the FSCs. The LCCs may also offer lower fares than surface transport, especially in Europe. Passengers respond quickly to these lower prices, and this enables the LCCS to grow rapidly.

5.4.2 LCCs' Sources of Advantage

The LCCs are able to offer a lower priced product, and to earn profits with them, because of two reasons:

1. They are offering a different product, which is less costly to produce, and
2. They are more productive, and have lower costs overall.

We consider each of these in turn.

1. Different Products

As mentioned, the LCCs operate with simple networks, and do not actively sell multiple stage trips. Their cabin service is limited. They have high seat densities. Their sales methods are simpler, and they do not have staff to offer advice on complex itineraries.

As a result of this, they are able to keep costs down. They can achieve high utilisation of their aircraft and crews. They save money by not or only partially using agents to sell their tickets, and on maintenance (by not having different aircraft types). They may use cheaper airports. In particular they avoid passengers who are costly to serve- who want detailed advice about itineraries, connecting flights, and extra pre-flight and in-flight service. Not everyone likes their product, but many do- they are willing to give up the advantages provided by the FSCs to get the price reduction.

This source of advantage is essentially in the product being offered- the LCCs have sought to offer a type of product which was not well provided by the FSCs before. This advantage can be matched by the FSCs. In principle, they can respond by making this type of product available. Some have done so by setting up their own LCCs- British Airways did this with Go, though it later sold this airline, which has ended up being merged with another LCC (BA found it difficult to have two types of airline in the one company). The other response is to simply offer the LCC type product at comparable fares, and fly the passengers on normal flights. This is feasible, but the flights they operate are optimised for the full service passenger, and they can be problems of integration (and they may not be able to obtain the operational economies, e.g. from not offering connecting flights, because expensive connecting flights have to be offered for the full service passengers).

2. Lower Costs

LCCs are able to achieve higher productivity overall, and especially labour productivity, than the FSCs. They do not necessarily pay lower wages, but they do have fewer staff for a given task, and require their staff to work more flexibly, undertaking multiple tasks. Thus they can provide a specified output with fewer staff than the FSCs can. They can do this largely because they are not locked in to old agreements with their work forces. These agreements are less demanding of staff, they have grown up over many years when the airlines were protected from competition, or were in a position of market dominance. Thus their costs are lower. Just how much lower is difficult to tell, because as noted above, they are providing a simpler, cheaper product than the FSCs. However, it is probable that most have a significant cost advantage.

In contrast to the product advantage, this advantage is difficult for the FSCs to match. They find it difficult to reduce their costs quickly, because they are locked into a particular way of working. Furthermore, airline staffs have been very reluctant to allow a worsening of their conditions, even when the airline they are working for is facing bankruptcy because of an inability to compete with its LCC adversaries. Few FSCs can change their ways of operating, and their labour arrangements, quickly. It takes time to do this, even when they realise the urgency of doing so (which is a reason why some have set up low cost subsidiaries, which are not bound by the old agreements). They cannot respond instantaneously, and at best they can respond over the medium term. It can be done- many, though not all, of the incumbent airlines in the US were able to survive the initial wave of LCCs, in the 1980s, by substantially reducing their costs and depriving the LCCs of this source of advantage.

5.4.3 Impacts

LCCS have had impacts which are disproportionate to their size or share of the market. There are few markets in which LCCs are dominant in terms of market share, and they do not serve all markets. The low fares they have offered have attracted passengers, and there has usually been rapid growth of overall demand in city pair markets in which LCCs have entered. Typically the FSCs have had to offer some lower fares, and this has contributed to demand growth. Overall yields in these markets have been falling. As might be expected, most of the impact of the LCCs is confined to the markets on which they actually serve, though there is some evidence of fares in related markets (e.g. other routes served from a hub into which a LCC is flying) falling, though not by as much as where there is actual competition. Sometimes, the FSCs have some scope for increasing high value fares, such as those for business class- this will moderate the overall decline in FSC yields.

As a result of this, there can be quite negative impacts on FSCs. Their profitability will decline, and they may incur losses on routes on which LCCs are present. Profits on other routes may enable them to survive in the short to medium term. Sometimes the competition is so severe that established FSCs are forced to exit the market- often these exits are a consequence of several factors, but the impact of the LCCs is usually a potent factor.

Because of their impacts on fares and traffic, LCCs are often credited with being the major force in developing tourism in regions. LCCs often fly to destinations which have not been known as holiday destinations (often these are not well served by charters), but they lead to a growth of tourism to these destinations. As a consequence, local authorities are keen to attract LCCs to their regions, and they sometimes subsidise them to come, perhaps by offering very attractive terms for airport use.

5.4.4 FSC Responses

The emergence of LCCs has posed major problems for the incumbent FSCs. They have been forced to respond- without doing so, their survival would be imperilled. Often they find it difficult to know how best to respond- cutting fares is easy, but it is costly.

The first, and necessary, response is to adjust the price structure, and to ensure that the market the LCCs are accessing is covered by comparable fares for comparable services. This will mean a loss of profit, unless loads can be increased and costs reduced- the latter is difficult to achieve in the short term. The airlines will try to increase prices on other routes, and on to high yield passengers- however their ability to do this depends on them facing little competition in these markets. Dropping fares can also attract the attention of the competition authorities- they are likely to be accused of predatory behaviour. While it is difficult to prove predation, the FSCs’ ability to respond can be constrained. In Germany, when Lufthansa responded to the entry of Germania by (nearly) matching its fares, the competition regulator forced it to increase its fares.

Another, longer term response, is to set up LCCs to compete. There have been several instances of this: Go (owned by British Airways), Buzz (KLM), Freedom Air (Air New Zealand). These airlines can capture the same cost advantages as enjoyed by the LCCs, by producing simpler products and negotiating more productive labour arrangements. There has been a problem of how these airlines can compete against the LCCs while at the same time not weakening the parent airline. In the end, Go and Buzz were sold by their parents.

The next response is to lower labour costs - this takes time. Contracts have to be re negotiated, and staff are unwilling to accept lower pay or worsening conditions; even when they see other FSCs failing because they have been unable to meet competition from LCCs. In the US, there have been cases of airlines going into quasi bankruptcy, repudiating labour contracts, and then renegotiating much more favourable contracts. The difficulties have been highlighted by the experiences of the major US carriers post 9/11- even though they have been teetering on bankruptcy, they have been finding it difficult to reduce costs. The experience of the US in the 1980s suggests that most FSCs can survive, but not all will.

Overall, the FSCs have found it difficult to adapt to a world in which LCCs are gaining considerable market share. As mentioned, they find it difficult to reduce costs quickly. However, they also find it difficult to develop the right products with which to respond to the competition- it is difficult for them to offer the simple, cheap (and cheaply produced) product within a more complex and extensive airline system, and they find it difficult to set up low cost subsidiaries which do not hurt themselves almost as much as their LCC competition.

5.4.5 Problems

There have been a number of problems which have emerged with the new environment of competition from LCCs. Some are more serious and/or difficult to resolve than others.

<u>Predatory Behaviour</u>
The FSCs are often large companies with extensive resources, and they have the scope to indulge in predatory behaviour. They may also have the incentive to do so. Thus they may cut fares below costs to compete the LCC off a route, or they may offer a superior product (with better connections, easier booking, frequent flyer benefits) at the same fare as the LCC. When a LCC is unwisely aggressive, the FSC may be willing to enter a price war with the LCC, knowing that it is the only one with resources to survive. Thus there have been several cases of predation alleged in those markets in which LCCs have made their presence felt.

Predatory behaviour cases are always difficult to resolve satisfactorily. On the one hand, the competition authorities do not wish to ignore it, and allow well resourced incumbents to push more efficient competitors off their routes. On the other hand, they do want incumbents to be able to respond and continue to provide a range of services to the market, many of which are not provided by the LCC. This situation is made more complex by the fact that, usually, FSCs are operating at higher cost than the LCCs, even though they are trying to reduce them as quickly as possible. Should incumbent FSCs with higher cost not be permitted to match fares offered by LCCs, because this would mean fares below cost for a time, which could be considered to be predatory?

<u>Instability</u>
LCCs can lead to a degree of instability in the airline market. They are often poorly capitalised, and they offer excessively low fares in the short term in order to attract business. They seek to grow very rapidly, and encounter the problems of firms which do so. Sometimes they have a major impact for a while, but then encounter a cash flow crisis and exit. In the meantime, the low fare competition can create a crisis for some FSCs- some of these fail. Because LCCs are changing the nature of the market quickly, because they are putting considerable pressure on cost structures, and because they themselves are poorly capitalised, they add a considerable degree of instability to the airline market. This is being evidenced in Indonesia, where there are some small LCCs offering very low fares which established carriers are finding difficult to compete with while staying profitable.

The downside of this is that there are costs, especially when airlines fail and markets are left poorly serve. This does into usually happen for an extended period, since other airlines step into the breach of the failed airlines. However, this is probably best seen as the price of innovation and competition. When markets are not being well served, because incumbents have excessive costs or are not supplying the products which the market wants, a period of realignment and consolidation will be needed if performance is to be improved. It is not likely to take place in a way in which no competitor is harmed.

Cream-skimming

It is sometimes maintained that LCCs simply seek out the profitable routes and leave the less profitable routes to the incumbent FSCs. It is true that LCCs will go for those routes which are highly profitable, probably because competition on them has been less than intense. However, the track record of LCCs shows that they are not simple “creamskimmers”. They have been showing willingness to enter routes which have been abandoned by the FSCs as unprofitable, and to try to operate these on a profitable basis. They have also been very active in developing new routes- e.g. direct flights to smaller cities, and often they have built these up. Entry by LCCs on to some routes will alter the patterns of yields on different routes. There are some routes (e.g. those with a high proportion of high cost business travellers) which LCCs are not well suited to serve. Some routes may be left to FSCs to serve, with relatively little competition and somewhat higher margins. In a competitive environment, ultimately all routes will have to cover their costs, and it does not make much sense to claim that LCCs only skim the cream.

5.4.6 LCCs in the ASEAN Region

Open Sky will provide fertile conditions within which LCCs can develop in the ASEAN region. Open Sky is not essential, in the sense that some involvement by LCCs is feasible even under current regulations, especially in the domestic markets of Indonesia and Malaysia. However, a situation in which there are no capacity controls, no price controls, and multiple designation is one in which LCCs can thrive. Currently, all of these exist within Europe, along with cabotage rights (though these are not much used), and they have resulted in an environment in which LCCs can develop with little hindrance.

The success of LCCs will depend on how strong the advantages they possess over the FSCs turn out to be. Are they existing carriers servicing low fare markets well? Evidence suggests that this might not be so in all cases. Are the existing FSCs productively efficient, producing at minimum possible cost? Again, evidence suggests that some, though not all, may be.

Their success will also depend on whether there is a market for the type of service they provide. The ASEAN market is different from the European and US markets. There are fewer high income persons, with the time and money to travel. However, even within relatively poor countries, there are emerging middle classes with discretionary income and a taste for travel. On average, business in the ASEAN countries are not as well off as their counterparts in Europe or the US, and thus they may be, on average, more cost conscious- to this extent they provide a ready market for low cost travel, such as is provided by the LCCs. Foreign travellers, who make up a significant part of the intra ASEAN air transport market, are also likely to be cost conscious. The ASEAN air transport market is much smaller than the European and US markets, and the market for low cost travel is likely to be correspondingly smaller. However, it is likely to be a significant market in which there can be several competitors.

The preconditions for successful LCCs do not exist in all ASEAN countries. LCCs require flexible capital markets and availability of risk finance, entrepreneurial flair, managerial experience, access to skilled labour, and good though not excellent infrastructure. These conditions do exist in most, though not all, ASEAN countries.

The impact that LCCs will have in the region will depend on how strong their advantages over the incumbent FSCs are. They will open up the less competitive markets, and will put pressure on incumbents to assess their cost and productivity levels. They are likely to result in lower fares on many routes, and they are likely to develop some new, primarily tourism, routes. This will create pressure for the improvement of tourism infrastructure. LCCs may make it difficult for some FSCs to survive; those with inefficient labour arrangements and an inability to respond to market changes will be severely weakened. Depending on the advantages they possess, they will be a strong force in restructuring the ASEAN air transport market. Open Sky in ASEAN will mean new forms of competition, not just more intense competition between the established airlines.

LCCs could play a major role in the process of moving to Open Sky. The move to Open Sky, as suggested below in Chapter 6, may involve opening up secondary gateways and markets before liberalising extensively. Overseas experience suggests that LCCs are good at serving these, since they have the flexibility to enter them quickly, and do not require high yields to serve them. Since these routes are less likely to be served by major carriers, they offer the LCCs the scope to develop during the early stages without encountering head to head competition from strong airlines.

6. POLICY OPTIONS AND PACKAGES

The term “Open Skies” does not refer to a single, well defined, policy option. Rather, it refers to a package of measures, which will differ from case to case. Most Open Skies packages do, however, incorporate a liberal operating environment for airlines, though some are more liberal than others. In designing the packages which will most appeal to ASEAN member countries, it is useful to identify a range of distinct policy options or building blocks. The impacts of each of these on country objectives can be then considered.

The Open Skies package being studied here is only concerned with internal air services, not external, to non-ASEAN countries. The ASEAN countries might decide to implement internal Open Skies, i.e. that they would extensively liberalise air transport amongst the member countries. They might also decide to opt for Open Skies with other, non ASEAN countries, or groups of countries. Thus they might choose to implement Open Skies for all ASEAN countries with the US, or with the European Community as a whole (if the members of the EC chose to negotiate as a bloc). These options are not considered in this study, though they can be noted for future consideration. There is however reference to external relations in some of the policy options.

Internal Open Skies could mean creation of a single aviation market amongst the ASEAN countries, similar to the European aviation market or the Australia New Zealand Single Aviation Market (SAM). Given the differing objectives and constraints facing the different members, such a market might contain exclusions for specific countries. These might be temporary; a country might join the aviation market as a full member once its aviation sector had developed to a specified stage. Less extensive models of liberalisation could be considered - for example, one in which Open Skies would prevail between individual member countries, but in which some restrictions on airlines from countries other than the origin destination countries would not have full access to a route (e.g. where there was Open Skies between Malaysia and Indonesia for airlines from those countries, but airlines from other ASEAN countries (e.g. Thailand) would not have unlimited access. This limitation may be time limited. The options apply to combination and all cargo services, though the latter may be liberalized at a faster rate than combination services.

This chapter outlines the policy options that can be considered in the implementation of ASEAN liberalization. It then examines the impact of these policy options on various variables and identifies some modifications to these policy options. The last two sections present a discussion of the advantages of developing sub-regional groupings and the policy stages that can be adopted.

6.1 Outline and Description of Policy Options

Policy options serve as the building blocks of any Open Skies package. There are several individual policy options, such as capacity liberalisation or pricing deregulation which can be set out in advance. This section outlines and describes the different policy options that can be considered in moving towards ASEAN Open Sky.

6.1.1 Remove Restrictions on Fares

Some ASEAN countries still impose price controls on airline services, though often the controls have ceased to have much force. Double approval is most commonly practised in bilateral agreements. As countries move toward open skies they may opt to adopt double disapproval which means that both countries must disallow the fare if it is not to be offered, consequently each airline will be allowed to determine its own tariffs based on commercial considerations. Authorities can only interfere if fares are found to be anti-competitive. However, an Open Sky agreement should leave the airlines with freedom to set prices. A move from Double Approval to Double Disapproval can be achieved by moving to a situation under which approval of a fare by the country of origin is all that is needed.

6.1.2 Relaxation of Investment and Ownership Controls

Many or most international aviation agreements specify that airlines from particular countries are permitted to operate on specific routes. The "nationality" of the airline is important, and it must be defined - often this is done in terms of ownership and effective control of the airline. This, in turn, gives rise to investment controls. There is a tendency towards liberalisation of these requirements as airlines become more internationally based businesses, and international regulation becomes less restrictive. However, some countries which pursue Open Skies agreements with their partners (e.g. the US) still impose rigorous ownership requirements.

In the process, countries might agree to accept the designation of an airline for the use of the agreed market access if the airline has its principal place of business in a designating country and with substantial ASEAN ownership or its own nationals, and there is effective regulatory control by the designating party. In the long term countries might opt to designate any airlines provided that the party accepting the designation is satisfied that the aircraft operating certificate (AOC) is granted by an authority that is acceptable to it and acceptable internationally (including by ICAO).

The principal place of business requires: legal establishment/incorporation, substantial proportion of operations, significant capital investment in physical facilities, a potential liability for tax, registration and basing of aircraft, and employment of a significant number of nationals.

6.1.3 Permit Multiple Designation

Competition is also hindered when there are only two airlines, one from each country (*single designation*), permitted to serve on a route. Countries which are liberalising either permit two from each country *(dual or double designation)* or more designated airlines from each country to serve on a route, or drop restrictions on the number of airlines altogether *(multiple designation)*.

6.1.4 Market Access: Remove Route Capacity Controls

Many air routes are still regulated with controls on the total capacity to be offered, or the capacity to be offered by specific airlines. The type of aircraft to be used is also restricted. Capacity controls are specified by using a benchmark aircraft type and then specifying the capacity in terms of multiples of the benchmark, e.g. in the Japan – Australia Air Service Agreement capacity memorandum, the benchmark type is the B.767-200 and other types such as B.747-400 are indexed to that type. These controls prevent effective competition between the airlines, and thus their removal is a normal part of an Open Skies regime. The options for ASEAN members are to relax the capacity controls by increasing capacity by a certain percentage per year (time-bound) or to completely remove the controls.

6.1.5 Grant Fifth Freedom Rights

Open Skies agreements may not necessarily imply any greater availability of fifth freedom rights. However, it is likely that a country which is concluding an Open Skies agreement with another may be disposed to allow its airlines on to routes with third countries on a fifth freedom basis. This issue will arise for both internal and external Open Skies for the ASEAN countries. An internal Open Skies package might include fifth freedom rights for ASEAN airlines (eg where a Singapore airline would be able to fly from Thailand to Vietnam).

6.1.6 Out of ASEAN 5th Freedom

While an Open Sky agreement may not necessarily allow any greater availability of fifth freedom rights beyond ASEAN, it is likely that a country will want to fly to major markets beyond ASEAN. An Open Sky package might include fifth freedom rights beyond ASEAN for the ASEAN airlines (eg. where a Thai airline would be able to fly from Vietnam to China) but not necessarily increased 5th freedom rights within ASEAN for non-ASEAN carriers.

6.1.7 7th Freedom within ASEAN

Seventh-freedom rights enable a carrier to carry traffic between two foreign countries on a service with no connection to the home country. Thus, Malaysian carriers would be able to fly between Indonesia and Thailand, without having to initiate or terminate flights in Malaysia, as they are currently required to do. This right is not seen as being essential to an ‘Open Sky’ agreement.

6.1.8 Market Competition

Under a code-sharing arrangement, an airline agrees to provide seats to its code-share partner, which are then marketed under the partner’s name. Code-sharing allows airlines to serve a market without having to operate their own aircraft. Code-share agreements are of many types, however the two most common types are a “block space” agreement where the marketing carriers take an agreed number of seats on particular flights for an agreed price and resells them, as if they were its own seats. The risk is transferred from the operating carrier to the marketing carrier. The other common type is a ‘free flow’ arrangement whereby there is no specific allocation of seats and the marketing carrier sells whatever number of seats that it can. The risk remains with the operating carrier but it is alleviated by the marketing efforts of the non-operating carrier. A hybrid variety is where the marketing carrier has a time limit in which it can sell its seats: it can sell any number (from 0 to 100%) on any flight, but must pay for the agreed annual number of seats. In moving towards ASEAN Open Skies, members might choose to permit code share agreements on non-competing routes (eg Manila-Bangkok-Yangon) only and prohibit joint services/code shares on a single route (eg. Singapore-Kuala Lumpur). Where there is extensive 5th freedom competition, e.g. SIN – BKK, then code-shares between dominant carriers may be more acceptable. The danger of code-shares when there are only two carriers on a route is that there becomes, in effect, only 1 carrier and competition is diminished. Some persons may feel that an ‘open sky’ should impose no restriction on code-shares but liberalization for participants in a business sector usually implies a requirement for protection of consumers.

6.1.9 Access to Airlines from Non Partner Countries

An important issue concerns whether airlines from non partner countries will be permitted to serve a route between two points. A route between two countries may be extensively liberalised, but under many bi-lateral Open Skies agreements, airlines from other countries are not permitted to serve it. Thus, a Singapore airline might not be permitted to serve a route covered by a Malaysia-Thailand agreement. In some cases, these rights are granted, especially where there is a regionally based move to Open Skies. For example, a British airline can fly between Germany and France under current European arrangements. The high level of 5th freedom rights granted to non-ASEAN carriers would not indicate that there should be restrictions to ASEAN carriers on the same routes. Whilst it is not proposed that ASEAN nations should withdraw non-ASEAN 5th freedom rights, such rights should be made available to any ASEAN country that wishes to exercise them.

6.1.10 Permit Domestic Cabotage

Airlines from other countries can be permitted to operate domestic services under some open skies agreements. Thus a New Zealand airline can fly domestic services in Australia. However, many Open Skies agreement do not permit this.

6.1.11 Remove restrictions in ground handling services

Under Open Skies, airlines should be free to choose their own operators. ASEAN members might opt to allow other ASEAN operators to handle these services in their airports. Alternatively, it can be opened to all operators (including non-ASEAN) in the future.

6.1.12 Remove or Relax Restrictions on Gateways

Most air services agreements often specify which gateways or airports must be used by airlines operating international routes. A moderate form of liberalisation would be to permit airlines to choose which gateways they wish to use. Countries might liberalise gateways generally, but impose specific restrictions on major gateways for environmental or capacity inadequacy reasons but usually for a limited period only. Airport capacity issues should not be used to artificially restrict use of negotiated rights.

6.1.13 Remove "Doing Business" Restrictions

The maintenance and development of competitive air services is often dependent on minimising restrictions and discriminatory practices on "doing business". Examples of these are the ways in which member economies choose to regulate ground handling arrangements, currency conversion and remittance of earnings, employment of non- national personnel, the sale and marketing of air services products and access to computer reservation systems, and payment of expenses in local currency.

6.1.14 Liberalize Charters

Charter flights have been extensively used to promote tourism in many European nations, US and Australia and these countries deregulated their charter markets first. The benefits and costs experienced by stakeholders helped them to prepare for the deregulation of scheduled services. Many Open Skies agreements permit charter flights with restrictions to certain destinations. However, it is possible to have a liberal approach in general even in areas where scheduled airline operations exist. There are now no distinctions in Europe between scheduled and charter services.

6.1.15 Cargo Liberalisation

Most countries have a more flexible approach to air cargo than to passenger issues. Cargo is less sensitive to "national identity" than to passengers. Some countries have liberalized their cargo sectors first, delinked freighter provisions from those of passenger services, removed restrictions in gateways and lifted restrictions on 3rd, 4th and 5th freedom capacity.

6.2 Assessment of Impacts of Policy Options

The next stage involves determining how these individual options are likely to work.

6.2.1 Remove Restrictions on Fares

Market-determined fares serve as incentives for airlines to respond more quickly to market changes as well as to fare changes by their competitors. Airlines become more equipped to cater to niche markets and to manage their yields better. Competition can cut into airline profits but as airlines gain flexibility for yield management, they will tend to compete for the high yielding business traffic on the basis of service quality, such as more frequent departures and the provision of airport lounges. Competition for non-business traffic will bring down fares and will stimulate travel by the price-sensitive leisure markets (thereby increasing tourism revenues). The experience of countries that have already adopted a double disapproval regime revealed that fares have declined as a result of this policy. Airline behavior is best monitored under a set of competition policies. At the least, there should be an ASEAN code of practice in relation to airline pricing practices.

6.2.2 Permit Multiple Designation

Multiple designation increases competition, which in turn forces airlines to become more efficient and eventually lower costs and fares. This is true in very dense markets. Consumers benefit from the wider range of choices available in the market. These choices could be over the types of fares and restrictions offered, the times of flying (e.g. there might be off-peak discounts) or the levels of service provided. Such a policy gives more flexibility to airlines to access and develop new markets. While multiple designation gives a country some flexibility to designate airlines, it also challenges authorities in allocating route and capacity entitlements. Transparency of process in allocation is essential to maintain a "level playing field". Multiple designation may not lead to lower fares if the market is very thin and if capacity is restricted on 3^{rd}, 4^{th} and 5^{th} freedom routes.

6.2.3 Market Access: Remove Route Capacity Controls

Removing capacity controls on seats, frequencies and type of aircraft used gives airlines the flexibility to respond to rapid changes in market demand (starting with 3^{rd} and 4^{th} freedom rights). More carriers (including LCCs) will be encouraged to apply for designation. Competition will bring down fares, allow airlines to gain reciprocal access to markets and help open up regional markets and increase inbound tourism. However, the benefits of removing these controls can be reduced by infrastructure-related constraints such as difficulty in securing landing slots. Expansion of airport capacity can be challenged by economic, environmental, political and physical constraints.

The combination of multiple designation and liberalized market access would make destinations more accessible. It will also create pressures on destinations to become competitive. However, some national airlines consider granting unlimited 3^{rd} and 4^{th} freedom rights as detrimental to their profitability because other ASEAN carriers, for instance, will only concentrate on the development of sixth freedom traffic rather than competitive 3^{rd} and 4^{th} freedom traffic.

6.2.4 Liberalize Charters

Charter operations can promote the growth of traffic given the restrictions in scheduled services. It can help in the development of tourist destinations not being served by regular flights. Liberalizing charter services will promote competition in these tourist destinations, bring down fares and provide opportunities for the development of low cost leisure and major event markets.

Charter services can influence the prices of scheduled services if they act as substitutes in a particular route. In the initial stages, ASEAN might consider opening up charter markets in routes where they will not directly compete with scheduled services but in later stages of liberalisation, the EU model should be adopted with an elimination of the distinction between charter and scheduled service.

6.2.5 Cargo Liberalisation

Removing restrictions on frequencies, tonnage and access to gateways would improve efficiency by allowing carriers to use back-haul space more efficiently than in a regulated system. Availability of services can open up new markets for agricultural products and high value technology-related goods for ASEAN. Shippers will also benefit from more choices in flight schedule and available space.

6.2.6 Remove or Relax Restrictions on Gateways

Opening up gateways (granting separate traffic rights to airlines operating to the gateways) can ease up congestion in the hub, help develop new routes and lead to more competition.

Tourism can benefit from new points of entry and exit and cost savings by not connecting to other domestic gateways for their international flights. Hence, domestic carriers can suffer from the direct services provided by foreign airlines.

This policy option also supports the entry of secondary carriers which cannot compete directly with established carriers in the hub due to airport-related constraints or insufficient capacity. The government can earn more revenues from airport operations. However, even secondary carriers will not be able to fully utilize these gateways if the required infrastructure facilities are not available. It must be recognised that secondary gateways cannot support high frequency and/or high capacity aircraft because of the small national markets.

6.2.7 Market Competition

Code-sharing offers new and existing carriers opportunities to access markets or expand networks without incurring expenses associated with actually operating an aircraft. It promotes competition among carriers on thin markets which cannot support many carriers. For the operating carrier, operating costs can be reduced since the non-operating carrier shares in marketing and selling seats. Revenues will increase.

To promote competition, ASEAN members might choose to restrict code shares between national carriers on prime 3rd and 4th freedom services (e.g. SQ/MH between Singapore and Kuala Lumpur) during the initial stages of regional liberalization and permit code shares in non competing routes. Convenience becomes a benefit to passengers. Where there is extensive competition or other benefits can be shown such, as global marketing of a secondary destination, then code-shares may be permitted. The rationale for restrictions on code-share is mentioned in 6.1.3. above.

This can lead to higher passenger traffic provided that capacity will not be lower relative to the demand in those routes.

6.2.8 Grant Fifth Freedom Rights

Fifth freedom rights are vital to support airline operations, particularly on ‘thin’ routes where traffic is light and markets are developing and also on short sectors at the end of a longer sector. It also argued that fifth freedom rights allow carriers to operate routes with greater frequency than can be sustained by third and fourth freedom traffic alone. Thus, airlines would be able to operate services with lower overall costs, and by increasing the size of their network they would be able to capture important marketing advantages.

6.2.9 Out of ASEAN 5th Freedom

Operating 5th freedom service beyond ASEAN allows airlines to exploit opportunities in their major tourism and trade markets which might be beyond its ASEAN routes, to develop traffic and increase revenues. National airlines might contest this option especially if they do not have the capability to carry the traffic themselves.

6.2.10 7th Freedom within ASEAN

Seventh freedom rights enable airlines to minimise the network costs of operating services between foreign countries by not linking them with other third and fourth freedom services. Passengers will benefit from more services in very dense routes.

6.2.11 Access to Airlines from Non Partner Countries

Airlines from outside of ASEAN can introduce competition in ASEAN 3rd and 4th as well as in 5th freedom routes beyond ASEAN. This can lead to more services, more choices and lower fares. However, the national flag carriers can be disadvantaged if they are not as capable or efficient as the non-ASEAN carriers. Priority in allocation of 5th freedom rights should be given to ASEAN carriers over non-ASEAN carriers.

6.2.12 Permit Domestic Cabotage

Cabotage is usually prohibited by national law. If allowed, cabotage can result in greater competition, better connections between domestic and foreign routes and lead to lower fares. Tourism will benefit from seamless travel. However, it can infringe on the viability of domestic carriers and does not usually lead to investment and job creation. Australia allows 100% foreign ownership of a domestic airline: this is sometimes called "investment" cabotage.

6.2.13 Relaxation of Investment and Ownership Controls

The nationality criterion has prevented airlines from competing on the basis of efficiency to provide lower prices and higher quality of services.

Some ASEAN members face difficulty in raising capital from their domestic capital markets. Joint ownership of an airline might be proposed in order to meet necessary start up and operating capital, to access wider management and operational expertise, to achieve cost savings through joint purchasing, or to provide traffic feed within a grouping of airlines. It will make airlines reduce their reliance on government, permit airlines to build more extensive networks through mergers and acquisitions or alliance thereby reducing costs. Benefits in the form of lower fares and better quality of services will then be passed on to consumers.

Some risks are associated with the move towards joint ownership and principal place of business criterion. These include potential capital flight and emergence of 'flags of convenience' carriers, which are nominally based in one country, even though they have few operations associated with that country (rather like 'flag of convenience' shipping lines') in case of absence of regulatory measures.

6.2.14 Remove Ground Handling Restrictions

Opening up the market for ground handling services to greater competition among ASEAN Operators first will lead to lower operating costs for airlines (compared to what a monopolist will charge) and improved quality of handling services. Airlines are given the flexibility to perform their own ground handling or choose from different suppliers. In the latter phase of liberalization, countries can consider the entry of multiple suppliers based on the size of the airport. Consumers can benefit from better quality of services if airlines pass on the cost savings to them.

6.2.15 Remove Doing Business Restrictions

As a result of the increasing number of alliances and the globalization of airline activities, removing the restrictions to the movement of airline personnel, foreign exchange convertibilities and marketing and selling of service will become increasingly important to airlines. Airlines will become more efficient in their operations in all parts of their network. Decisions can then be based on commercial considerations. Consumers will benefit from better quality of services.

6.3 Limits on Policy Options

Since several or most of the options considered will impose some losses on some countries, it will be necessary to determine if there are any modifications which can be made which will reduce or eliminate the losses. Some policies may not be amenable to modification. However, the problems created by some policies may be capable of being addressed. This section explores the various modifications on the policy options presented above.

6.3.1 Regional Special Arrangements (CLMV, BIMP-EAGA)

Given the wide disparities in economic growth, approach to air transport regulation, capabilities of the airlines and the crises experienced in recent years, it is possible to form smaller sub-regions where the building blocks towards an ASEAN Open Skies will be carried out. There are three sub-regional cooperation agreements today, namely BIMP-EAGA and IMT-GT and the CLMV (which is a relatively bigger one in level of cooperation). The BIMP-EAGA and IMT-GT allow cooperation among secondary/tertiary points in the countries involved. However, progress in these two sub-regions has not been significant in the past years. ASEAN can consider the option of forming new sub-regional blocs that involve cooperation at the national level (similar to the CLMV) and not just secondary and lesser points.

6.3.2 Lead Sector Approach

The policy options considered in the previous sections can be adopted or implemented first within the sub-regions and later on a wider scale as the sub-regions integrate over a specific time period. It is possible for instance to adopt a phased-in program that will exclude cargo and charters from the traditional requirement of substantial ownership and control and adopt the criterion of principal place of business within the sub-regions. Even restrictions on capacity and market access can be removed first with cargo and charters. Countries will now be able to witness the benefits generated from such a phase-in program.

6.3.3 Route/Gateway Restrictions

Countries might be hesitant to open up their capital cities to all ASEAN carriers. An option is to open up a few secondary gateways in the initial stages of the region-wide liberalization and restrict the major flag carriers from operating to some secondary gateways for a specific period of time. This will allow smaller carriers to build up their markets and operations.

6.3.4 Capacity Controls

As a transitional mechanism, countries might choose not to immediately open up their 3rd and 4th freedom routes. However, they can still increase capacity that will more than match the demand for services by institutionalising a trigger mechanism or by increasing capacity by a certain percentage per year while reserving half the increase for non flag carriers.

As for 5th freedom beyond ASEAN, for instance, it is a possible option for countries to impose some limits or restrictions for a specific period of time in order to allow ASEAN carriers to build up the markets.

6.3.5 Permit Co-terminalisation

An ASEAN member country might choose not to grant cabotage rights to other ASEAN carriers. However, in order to provide better connectivity to passengers and support development of routes, countries might allow co-terminalisation and own stop-over rights.

6.3.6 Code Share Agreements

In the initial stages of liberalization, ASEAN members might choose to restrict code shares on routes where there is no 5th freedom competition routes for a specified period of time and to grant limited code shares in non-competing routes.

6.4 Sub-Regional Initiatives

There are a number of sub-regional initiatives, both in and outside of the air transport sector within ASEAN, however we are concerned only with those that impact upon air transport. The proposed CLMV (Cambodia, Laos, Myanmar, Vietnam) air service agreement is, as its name states, restricted to air service between the four participants, whereas the BIMP-EAGA and the IMT-GT are considerably broader agreements which includes air transport but which, at least in the air transport sector has had relatively little implementation.

It is believed that a single 'big bang' approach to 'open sky' is not feasible within ASEAN, if for no other reason, than that the weaker economies are concerned that the stronger economies will so rapidly dominate the aviation sector that the airlines and associated infrastructure and service providers will be unable to grow to a sufficient size to gain economies of scale and scope in a reasonable time frame and possibly not at all. If the 'big bang' approach was adopted, and it failed, there would have been no progress, there would be no gain for potential winners and the current losers would continue to lose. Hence, we are proposing a gradualist approach and within this gradualist time scale, we see a need to recognise the progress that CLMV and BIMP-EAGA have made, and the promise they have for the future but to build on the sub-regional approach by adding to the sub-regions, by the creation of new air service sub-regions and, importantly, by proposing an acceleration of the rate of change through a number of packages of change. The packages recognise that these matters will take a long time to be negotiated and implemented and will move at the same time as the new and sub-regional agreements are created. There are three sub-regional agreements being proposed namely: CLMV +T + B, VIP+B, and STM + B. The following sections will present the rationale behind the formation of the three sub-regions and how they will be integrated towards an ASEAN-wide Open Skies.

6.4.1 Sub-Region 1: CLMV + T + B

Sub-regions can be based on a similarity of economic and aviation strength. It is apparent that three of the four CLMV countries are in a similar (but not identical) position in their aviation situation. The same three which are at a fairly low level of development, also have economies which are still to be optimised. Vietnam is in a stronger position: its aviation sector is in a strong growth mode, with its principal air carrier, Air Vietnam, now able to provide non stop wide-body service to Europe and US and to provide technical assistance in the form of air crew and engineering support for Lao Airlines' recently introduced A.320 aircraft.

Whilst there is a degree of imbalance between Vietnam and the other 3 participants, the imbalance is not as great as if the request by Thailand to join the CLMV grouping had been agreed upon.

The geographic and market position of Thailand is however such that the advantages to the CLMV participants of Thailand being involved will outweigh negative elements of perceived dominance. It is proposed that after the agreement comes into effect, that it be initially expanded to include Thailand, however Thailand should be admitted in stages, so that the lesser carriers are not overwhelmed by the strength of Thailand's airline sector. Thailand has not only Thai Airways International but 4 other private sector carriers which offer jet equipment of various types. Three of the four operate to CLMV countries (Bangkok Airways/Phuket Air/PB Air). It is considered that the staging could occur in 2 ways. The first way would involve geographic limitation on 5th freedoms and the second way would involve capacity limitations on routes.

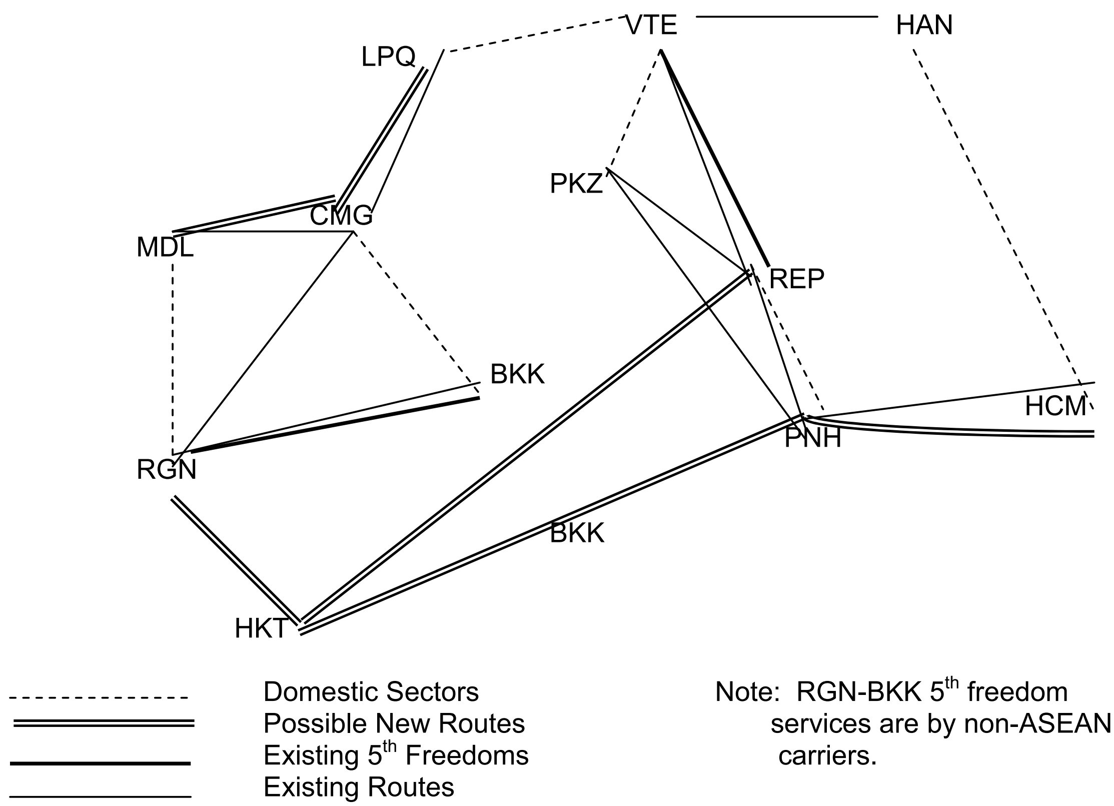
Admitting Thailand into CLMV

The First Stage: The Geographic Limitation

Thailand has a clearly enunciated policy of creating regional hubs at Chiang Mai and Phuket. By providing 5th freedom access to CLMV carriers at these 'hubs' it would assist not only the growth of the hubs, but be a first step in the admission of Thailand to full participation in the CLMV agreement. Of course the small CLMV carriers can benefit by having 5th freedom traffic opportunities and thus have the prospect of success in what would otherwise be markets which are too small for the operation of successful routes. It must be recognized that inter-governmental arrangements can inhibit commercial success or they can provide a framework in which commercial success is possible, but they cannot make commercial success occur -only the airline operator can establish the commercial operations which will bring profits and growth.

The current CLMV services are limited, with Myanmar not being connected to any of the other parties by direct air service and there is only one 5th freedom route operated by a CLMV carrier.

Figure 6-4-1 Admitting Thailand into CLMV: Existing and Potential Routes



However, there is scope for the creation of services if the proposed regional hubs were to be added, for example, RGN – CMG – LPQ or RGN – HKT - REP.

The Second Stage: Capacity Limitations

In the second stage of Thailand's admission to CLMV, there could be controls so that the impacts of Thai Airways International were minimized on the smaller carriers. These controls could be in terms of capacity and in time based limitations on 5th freedom.

In the second stage, all points in Thailand would be available for 3rd, 4th, 5th freedom traffic (in essence, Bangkok), but the designated carrier of Thailand could only operate either the level of service provided at the date of implementation or daily service, i.e. if there was a route on which TG operate less than daily at the date of implementation, then it may increase its service up to daily, until the carrier of the partner CLMV country operates a matching frequency level and then each may increase in equal installments. A device such as this will restrict the dominance of the bigger participant and give the smaller participant time to grow. On the secondary routes, 2 and 3 country code-shares may be appropriate in order to benefit from the marketing and network resources of the major carriers. On primary (capital to capital routes) bi-lateral code-shares should be avoided, as they are, generally anti-competitive, unless there is either or both of, substantial 5th freedom competition and multiple designation by each of the two countries.

Admitting Brunei into the CLMV + T

This collection of letters is the original CLMV but with Thailand added, in a staged way. As seen above the staging was in two ways – staged geographic access and a staged capacity access with some suggested limits on commercial practice. It is possible to further expand CLMV + T by allowing Brunei to enter the arrangement. Brunei is a country that is very sympathetic to liberal aviation arrangements, being a participant with Singapore and others in the so-called 'APEC Multi-Lateral' open skies agreement. Brunei, in ASEAN terms is a medium sized aviation power. It does not operate any service to any point in CLMV but it does operate to Bangkok in Thailand, but then only 4 times per week. The tourism visitor flows between Brunei and the CLMV countries are very low and are not favourable for the introduction of direct services, however 5th freedom services have some potential to be viable, especially over Bangkok.

If Brunei were admitted to CLMV + T, then there would be an open skies agreement involving half of the ASEAN nations and including one of the three aviation super powers.

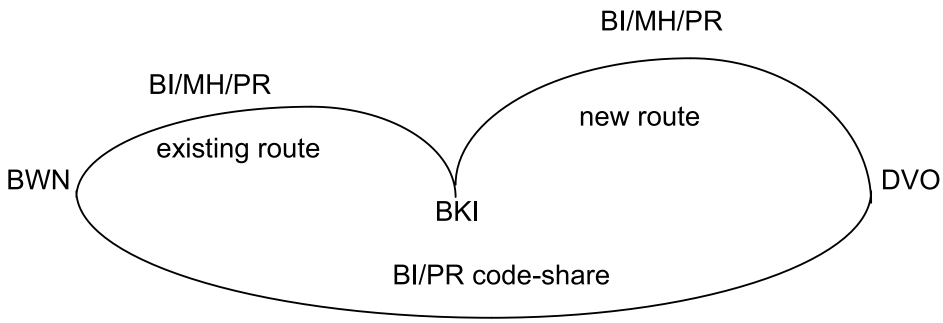
The BIMP-EAGA

The BIMP-EAGA agreement in so far as it deals with aviation, relates to regional, secondary and tertiary points: it is perceived as being relatively ineffective and is little used, there being few services operated, however if all participants were to agree to a full introduction of 3rd, 4th and 5th freedom services between all nominated points in the BIMP-EAGA participating countries, then the carriers would be free to decide for themselves if services could be mounted.

It may be that code-share or even joint services may be appropriate to create the linkages. Third country code-shares would also seem to be appropriate in order to build the initial linkages and when traffic is built to an appropriate level (most probably daily), any increase should be used to reduce the anti-competitive element inherent in code-shares/joint services.

An example of the type of route that might be created and involving multiple code-shares is the following. It involves 3 countries, 1 operating carrier and 2 marketing carriers.

Figure 6-4-1 Proposed BIMP-EAGA Route with Multiple Code Shares



Whilst the development of BIMP-EAGA is focused on secondary/tertiary points, there are two other geographically related regions that could also establish an ‘open sky’ regime between themselves.

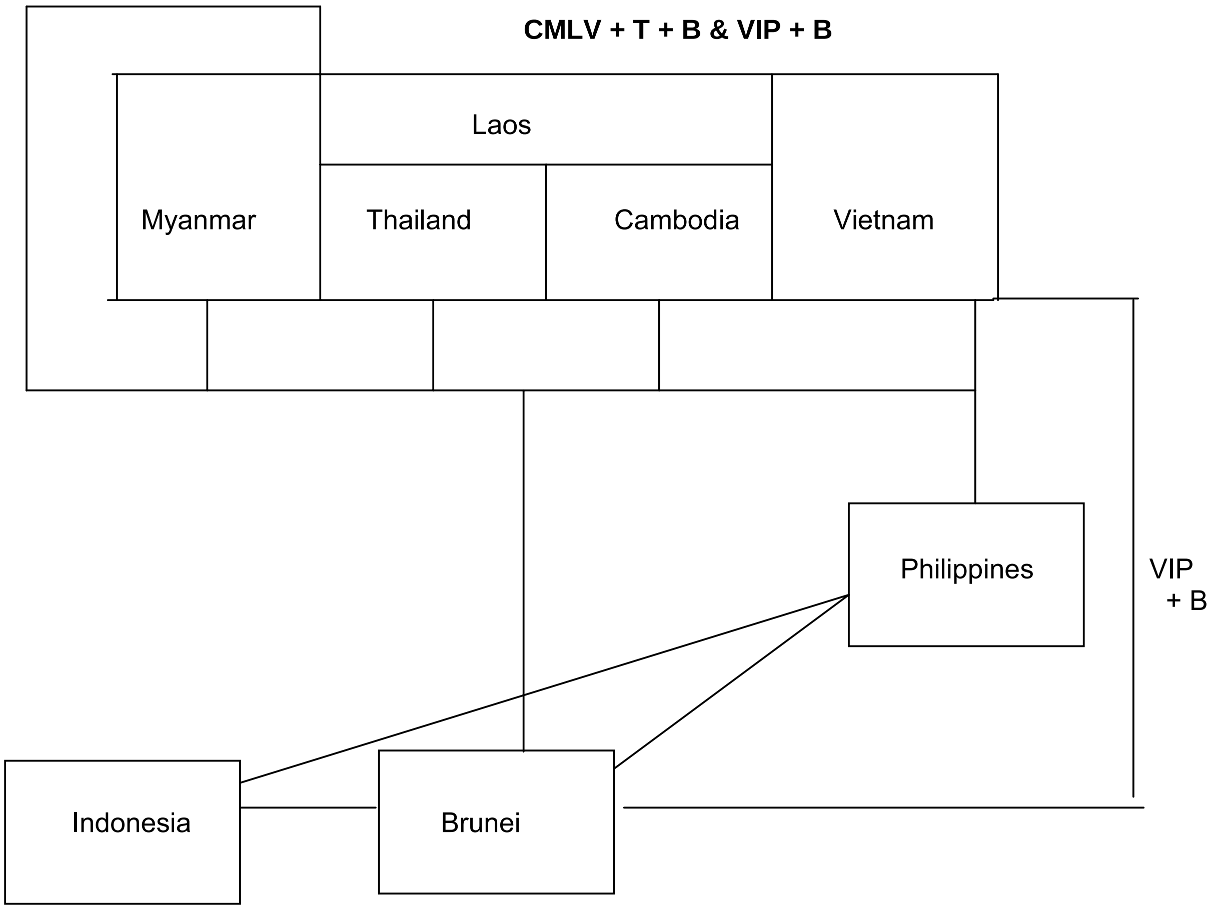
6.4.2 Sub-Region 2: VIP + B

The first is the secondary aviation states: Vietnam/Indonesia/Philippines. They constitute 3 generally similar aviation powers. The Philippines and Vietnam already have a type of 'open skies' bi-lateral agreement. In a later stage of development, this grouping could be added to the next to be discussed, “the super powers”: Singapore, Malaysia, and Thailand.

It is obvious that there is already cross-over. If it is assumed that an ‘open sky’ package is devised for the three intermediate powers: Vietnam, Indonesia and the Philippines, then we already have a crossover. Vietnam would be in two open sky agreements and the number of 5th freedom opportunities for Vietnamese carriers within ASEAN is considerably expanded.

The addition of Brunei, with its liberal approach would mean a further liberalisation of opportunity, as it too would be in two regional groupings, as well as its Singapore agreement. The situation is displayed thus on the page following.

Figure 6-4-2. Diagrammatic Presentation of Proposed Sub-regional Arrangements



Vietnam and Brunei: 2 agreements each
All other countries, 1 agreement each

6.4.3 Sub-Region 3: SMT + B

One of the major and well recognised difficulties of moving quickly, let alone in a 'big bang' to ASEAN open skies is the aviation, trading and general economic power of the big 3 – all have airlines with large fleets (see Table 6-4) and each of the three has at least two airlines with more in the planning (these state owned carriers are widely supported by their governments).

TABLE 6.4 FLEET SIZE: SUPER POWERS

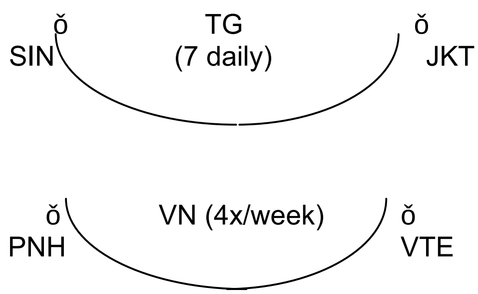
Aircraft Type	No. in Fleet	Approximate Seats Per Aircraft	Approximate Seats Per Type
Malaysia			
330	9	294	2,646
734	39	144	5,616
737-BBJ	10	UK	-
747-200F	5	100 tonnes per flight max	-
744	17	386	6,562
74M	1	100 tonnes per flight max	-
772	15	278	4,170
DHC-6	6	19	114
Fokker 50	10	50	500
Totals Malaysia	112	Total Seats	19,608
Singapore			
310	9	183	1,647
343	5	265	1,325
744	39	375	14,625
772	34	288	9,792
773	8	332	2,656
Totals Singapore	95	Total Seats	30,045
Thai Airways			
AT-7	2	66	132
AB6	21	216	4,536
333	12	305	3,660
M.11	4	285	1,140
734	10	144	1,440
743	2	405	810
744	16	389	6,224
772	8	358	2,864
773	6	388	2,328
Totals Thai	81	Total Seats	23,134

Source: Air Transport World, web-sites

It would be relatively straight forward for these 3 countries to agree on an 'open sky' package. Although Singapore has the largest international airline of the three (and one of the world's most successful airlines over time), its strength is balanced by the larger population base of the other two participants, their domestic markets and their further advanced non-government airline sector. Thailand has several private sector carriers and Malaysia 2 private carriers (Air Asia – a LCCC and Trans-Mile – all cargo).

Each country already has a very open 3rd and 4th freedom capacity regime with each other and whilst there are a considerable number of 5th freedom sectors flown between Thailand and Singapore and a number (but fewer) between Thailand and Malaysia, there are only 3 carriers flying 5^{ths} between Kuala Lumpur and Singapore. None of the 5th freedom sectors are flown by any ASEAN carrier. There are only 2 5th freedom sectors within ASEAN currently flown by ASEAN 5th freedom carriers.

Figure 6-4-3 ASEAN 5th Freedom Operations



Summary

On the assumption that the "super powers" can reach agreement, then there are 3 sub-regional "Open Sky" agreements, all having ideally the same text, but, at the very least similar basic texts. It is not envisaged that there would be any need for phasing any element of the "super powers" agreement. It may even be that Brunei would feel that it could comfortably join the super powers agreement: it being already in agreement with Singapore and through CMLV + T + B, involved with Thailand (as well as through its on-going bi-lateral) and thus further enhance the linkages and opportunities.

6.4.4 The Time-Scale for Regional Agreements

Notwithstanding that further liberalisation of the CMLV should be delayed until after the currently proposed agreement comes into effect, the time scale for the sub-regional agreements should not be too great. ASEAN should aim to have the sub-regional agreements in place by 2006, with further liberalisation to occur in the phases set out above.

6.4.5 The Linkages Between The Sub-Regions

The sub-regions will eventually merge, but this could take a long time: maybe it will be 10 years before there is sufficient confidence in the resilience of the small participants to withstand the strength of the larger players. Some of these concerns may of course be misplaced – it has become apparent that the strategies of the big players are in areas of global expansion. Both the Malaysian and Thai carriers have lost money in domestic operations and all short-haul operations, especially in thin markets, are difficult to establish and operate profitability. One of the key reasons for the suggested long time frame is that the ASEAN Secretariat is just that, in no way does it approach the powers of the European institutions flowing from the Treaty of Rome and cannot impose policy change in order to achieve rapid progress.

Until there is a merger of the planned sub-regions into one ‘ASEAN Open Sky’ the linkages will be complex and whilst there will be some cross over by individual countries, many aviation relationships will still be maintained on a bi-lateral basis.

The following tables demonstrate the relationships of the sub-regional agreements: the initial stage where there are 3 sub-regional agreements and the 2^{nd} stage with 2 sub-regional agreements.

TABLE 6-4-5: ASEAN OPEN SKY LINKAGES: INITIAL SUB-REGIONS

	Brunei	Cambodia	Indonesia	Laos	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam
Brunei	X	1	2	1	3	1	2	3	1	1
Cambodia	1	X	4	1	4	1	4	4	1	1
Indonesia	2	4	X	4	4	4	2	4	4	2
Laos	1	1	4	X	4	1	4	4	1	1
Malaysia	3	4	4	4	X	4	4	3	3	4
Myanmar	1	1	4	1	4	X	4	4	1	1
Philippines	2	4	2	4	4	4	X	4	4	2
Singapore	3	4	4	4	3	4	4	X	3	4
Thailand	3	1	4	1	3	1	4	3	X	1
Vietnam	1	1	2	1	4	1	2	4	1	X
No. of Bi-Laterals	0	4	6	4	6	4	6	6	2	2

Total Bi-Laterals: 40

Key: CMLV + T + B = 1, VIP + B = 2, SMT + B = 3, Bi-Lateral = 4

If however, it were possible to have a merger of VIP + B (2) and SMT + B (3), then the chart describing the linkages would be as follows.

TABLE 6-4-5: 2ND STAGE, SMT + B COMBINES WITH VIP + B

	Brunei	Cambodia	Indonesia	Laos	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam
Brunei	X	1	3	1	3	1	3	3	3	1
Cambodia	1	X	4	1	4	1	4	4	1	1
Indonesia	3	4	X	4	3	4	3	3	3	3
Laos	1	1	4	X	4	1	4	4	1	1
Malaysia	3	4	3	4	X	4	3	3	3	3
Myanmar	1	1	4	1	4	X	4	4	1	1
Philippines	3	4	3	4	3	4	X	3	3	3
Singapore	3	4	3	4	3	4	3	X	3	3
Thailand	3	1	3	1	3	1	3	3	X	1
Vietnam	1	1	3	1	3	1	3	3	3	X
No. of Bi-Laterals	**0**	**4**	**3**	**4**	**3**	**4**	**3**	**3**	**0**	**0**

Total Bi-Laterals: 24

Key: CMLV + T + B = 1, VIP + B + SMT + B = 3, Bi-Lateral = 4

Bi-Lateral Agreements

Even after the establishment of the three sub-regional agreements, there would be 40 bi-lateral agreements remaining. The merger of sub-regions 2 and 3 would reduce the number to 24. It would be of benefit prior to the establishment of the ASEAN "open sky" to develop, using the ICAO format as the beginning point, a standard bi-lateral text and offering optional but standard liberal clauses. Whilst it is unlikely that 40 identical agreements can be reached, standardization of bi-lateral text will simplify the multi-lateral process in the future as the diversions will be fewer.

BIMP-EAGA and IMT-GT – The Sub-Regional Process

As these agreements, in so far as aviation is concerned, involve primarily secondary and tertiary points, it can just sit, be utilised if and when appropriate, but when VIP + B merges with the 'super powers' agreement, then there is no practical need for their continuity in the aviation sector.

6.5. Towards an ASEAN Open Sky

6.5.1 The Phases of Reform

Since a 'big bang' approach is not feasible for ASEAN, it is proposed that policy reforms be implemented in three phases. Each phase combines policy options and reforms. *These phases allow for the achievement of the Road Map target of Open Sky by 2015, allowing for a degree of flexibility in timing.*

Figure 6-5 Proposed Phases of Reform

Phase I

Commences 1.1.2005 and continues for 3 years until 31.12.2007

↓

Phase II

Commences 1.1.2008 and continues for 3 years until 31.12.2010

↓

Phase III

Commences 1.1.2011 and continues for 2 years until 31.12.2012

In Phase III, a new reform agenda should be established for implementation 1.1.2013.

6.5.1 Open Sky Implementation Schedule

The policy options discussed in the earlier sections can be considered for implementation based on the following schedule.

TABLE 6-5. OPEN SKY IMPLEMENTATION SCHEDULE

	Phase 1	Phase 2	Phase 3
<u>Fares</u>			
Double Disapproval	·		
No Controls		·	
<u>Designation</u>			
Double Designation	·		
Multiple Designation		·	
<u>Ownership</u>			
Substantial ASEAN O'ship	·		
Principal Place of Business			·
Capacity – ASEAN Carriers			
Unlimited 3rd & 4th	·		
Restricted 5ths beyond ASEAN		·	
Unrestricted 5ths within ASEAN			·
beyond ASEAN			·
Foreign (non-ASEAN) carriers			
within ASEAN 5ths			·
Outside ASEAN 5ths			·
<u>7th Freedom & Cabotage</u>			
7th Freedom) Cabotage)	ASEAN carriers, not programmed but may be offered non-ASEAN carriers not programmed and not to be offered.		
<u>Market Competition</u>			
Code-Shares with ASEAN Carriers.	No primary routes/city pairs c/s. If 5th freedom competition - no new code-share, existing ones to remain but eliminated by 3rd phase. If no 5th freedom competition, no new and eliminated in 2nd phase.		
With Non-ASEAN Carriers	No new code-shares with ASEAN carriers but see next point		
Reciprocal Code-Shares	Permitted for Development Routes		
<u>Gateway Access</u>			
Primary Gateway(s)	· (except for BKK in CLMVT)	·	
Secondary Gateways	· (Target)	· (Essential)	

	Phase 1	Phase 2	Phase 3
Ground Handling			
Self-Handling Option		·	
3rd Party Handling Option			·
"Doing Business"			
Transfer of Staff	·		
Transfer of Funds	·		
G.S.A. Freedom of Appointment	·		
Other Aspects		·	
Charters			
ASEAN Carriers –			
Open Passenger	· extending to	·	
Open Cargo	·		
Non-ASEAN Carriers	Continue existing policies of assessment by application.		
Scheduled Cargo			
ASEAN Carriers Complete Liberalisation, including Gateway Liberalisation	Follow ASEAN path being separately developed		
Non-ASEAN Carriers	Avoid 5th freedom in ASEAN but encourage new market access for exports.		

6.6. Policy Options under the Phases of Reform

6.6.1 General

As was seen in the European context, reform took place over a number of years. There was time to adjust to the new environment for both the operators and the regulators. There have been changes that were not foreseen, and neither was the extent of their occurrence. As an example, the reduction in "charter" activity and the explosive growth of low cost carriers came as a surprise to many European airline participants and observers.

One of the elements of reform provided for in Europe was cabotage. This is seen as "a step too far" for the ASEAN economies and will not be part of the recommended packages, however it is noteworthy that there is currently very little cabotage flying performed in Europe. At the beginning of the "3rd package" (of European reform), a number of cabotage routes were flown but it was quickly discovered that the operation of domestic services with low frequencies was not profitable. The single biggest problem was a marketing one, i.e. it was difficult to convince the passengers that not only did British Airways, for example, fly to 6 places in the UK from a place in Italy, but that it also flew with low frequencies, to places within Italy. Alitalia, inter alia, had domestic brand power and frequency and thus, market share and yield advantages. The introduction of regional jets, i.e. a change in technology, also reduced the need for co-terminalization and thus cabotage.

In the reform packages that follow in outline form there will be no recommendation for cabotage, as it is not seen as being helpful to the liberalisation process of the weaker countries and that generally, a change to a principle place of business test, together with liberalisation of foreign investment in the aviation sector will produce economic benefit without the threat of intolerable damage to domestic carriers.

The issue of co-terminalisation is related. There have been concerns expressed, during the field trips, about the desirability of co-terminalization, i.e. the ability of a carrier to serve two points in the one country on the one flight.

Figure 6-6-1 Example of Co-terminalization

ǒ ________________ ǒ ________________ ǒ

e.g. SIN PNH REP

Cambodia

The advantage of co-terminalization is that it enables the carrier to serve what otherwise would be separate markets with enhanced frequency. In some extreme cases, it may be the basis of the existence of the route: without the co-terminals there would be insufficient traffic to either destination to justify a discrete flight. It is sometimes seen as a threat to domestic carriers but as long as rights between the co-terminals are restricted to carriage of own stop over traffic, i.e. a passenger who was either brought to the first of the co-terminals by the carrier or who will exit the country from the second of the co-terminals by the carrier, then there will be little impact on the true domestic market but gains from having optimal frequency to two gateways.

6.6.2 The Policy Options

There is a range of policy options that can be put into packages to be introduced over time. A complex pattern of geographic based sub-regional agreement supplemented by continuing bi-lateral agreements provides the framework upon which the liberalization packages are built. It will be a major challenge to have common policies in each of the 3 sub-regional agreements. It is possible that participants will not be ready to make reform at the same pace or in the same direction in all agreements but when the merger of two (or more) sub-regional agreements occurs then it will simplify that agreement, if the pre-existing sub-regional agreements can have as much policy equivalence and ideally, drafting equivalence, as possible (see Appendix 5). To this extent a standard for both bi-lateral and multi-lateral agreements is recommended.

The policy options which have been identified earlier will be explained in the context of the implementation schedule outlined above.

<u>Fares</u>

Even countries that formally require fares to be filed with authorities find it not feasible to enforce the fares. The reality is that there is generally a free market in air fares. On some routes there may be no or only a very limited spread. This is particularly noticeable where there are few carriers and/or where there are code-shares between dominant carriers. Some countries, e.g. Australia, require a fare and rate filing when the initial license application is made and issue a formal approval. Thereafter, if a carrier files a fare, no action is taken.

The advent of internet agencies and internet selling by airlines as well as the use of consolidators and multi-carrier constructed fares mean that fares, on a route basis, can be very dynamic. It would be appropriate to have a formalised double disapproval regime, however it is important to observe that where there is extensive competition, fares will be discounted, irrespective of the level approved (or not approved). Where there is no or little competition fares tend to be higher (all things being equal).

<u>Ownership</u>

It is of some disappointment that in the forthcoming CLMV agreement the traditional ownership and control clauses have been maintained. The March 2003 ICAO ‘Liberalisation’ Conference addressed this issue at some length and the working papers for this conference contained a comprehensive discussion of the link between nationality, designation and market access. In considering this aspect of liberalisation, it is important to remember that a state both makes a designation and accepts a designation and could have a different policy for grant of a designation as opposed to accepting another country’s designation.

The ICAO working paper reached 5 principal conclusions. In summary these conclusions were:

- Growing privatisation, globalization and liberalisation call for regulatory modernization, particularly in respect of conditions of designation and authorization of air carriers. Such modernization is not seen to conflict with obligations under the Chicago Convention.
- There is a continuing need to ensure safety and security as well as to monitor the economic and social impacts of foreign investment in aviation.
- The draft article provided by ICAO (ATCON5, WP/7 – Clause 4.6) is a practical way of introducing the principal place of business test.
- This step has the potential to be a catalyst for further liberalisation.
- The principal place of business test provides an opportunity for a state to accept designation of a foreign carrier ahead of accepting the principle for application to its own carriers.

The principal place of business is not an absolute black/white test but is seen to require the following to be in the territory of the designating party:

- Legal establishment/incorporation;
- Substantial proportion of operations;
- Significant capital investment in physical facilities;
- A potential liability for tax;
- Registration and basing of aircraft; and
- Employment of a significant number of nationals.

ASEAN countries now accept the designation of one or more of the three Hong Kong carriers on the basis of principal place of business and it would be an easy step to accept a carrier from another country on the same basis.

It is proposed that the ICAO recommended clause be adopted as a Phase 1 reform provided that the carrier maintained substantial ASEAN ownership and control, i.e. ASEAN countries liberalize as between themselves before they accept designations (other than Hong Kong which is now accepted) from non-ASEAN states, though of course, acceptance of a designation on this basis can still occur on a bi-lateral basis.

Designation

Ownership and designation are closely related. There are further steps (once the ownership/designation) matter is resolved and that is to move from single designation to double designation and then to multiple designation. It is of course, possible to designate on a route specific basis. On a very dense route, multiple designation may be seen as appropriate, whereas on a less dense route, double designation may be seen as providing sustainable level of competition, however on very thin and/or new routes, a single designation policy for a limited time may give the opportunity for route stabilization. On such routes, however, no two country code-share arrangement should be permitted and when a carrier reaches a frequency level of daily service, a second carrier should be allowed. The restriction has an automatic removal trigger built into it.

Double designation should be introduced for all primary and secondary routes in Phase 1, and multiple designation in Phase 2 of the liberalization process. Routes unable to sustain daily service are not required to be subject to double/multiple designation.

Designation of more than one carrier on a route delivers the benefits of competition, both in terms of fares and service elements (departure times/aircraft type/service style etc).

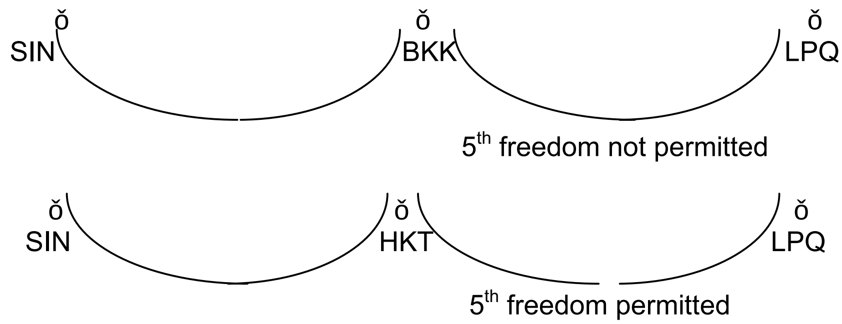
Capacity & Fifth Freedom Rights

Capacity is related to the above issues of designation. Capacity is an issue that is best left to the operators to determine. Attempts by governments to manage the capacity operated by restricting number of frequencies and/or seats have usually led to high load factors, shortages in peak periods and high fare levels with a consequent restriction on market growth.

ASEAN countries should agree that there be no limits to 3rd and 4th freedom capacity as between themselves. Some countries already have this situation, others are encouraged to move in this way in the first phase. There may however be a case for some restrictions on 5th freedom operations, especially by major carriers on thin routes or to secondary destinations.

If, however, a carrier wishes to open a brand new route using 5th freedom rights, then there should be no restriction. The following example is illustrative of this recommendation.

Figure 6-6-2. Recommendations on Fifth Freedom Rights: An Illustration



There are ways to restrict 5th freedom rights even when they are allowed. These restrictions can be on the basis of a percentage of the seats on the aircraft, e.g. no more than 50% of the (say) 140 seats of an A.320 on any one flight may be offered for 5th freedom carriage. This is a preferred method to a total number of passengers over a stated period of time but all restrictions are very difficult to enforce. Whilst any restriction may be seen as anti-competitive it is recognized that until there is total liberalization within ASEAN, that some carriers will seek protection from 5th freedom competitors and that it is better to allow some competition than none at all.

There are only two intra-ASEAN 5th freedom routes flown by ASEAN carriers: TG (BKK – SIN – JKT vv) and VN (HCM – PNH – VTE vv). There are extensive 5th freedom flights within ASEAN by non-ASEAN carriers. These are listed on Table 6-6.

Whilst the focus of this study is on 'within ASEAN liberalization', the ASEAN members do not stand alone, isolated from other countries. Bangkok, as an example, has direct one flight number air service to 76 cities outside of ASEAN. Singapore has 99 direct one flight number linkages.

ASEAN carriers do fly to a very large number of points outside ASEAN. Some of these services utilize 5th freedom rights. On some of these routes the 5th freedom may be wholly outside of ASEAN, e.g. between 2 points in Europe or 2 points in the Middle East or between a point in each, but as well, an ASEAN carrier may operate a 5th freedom service from an ASEAN point to a point outside ASEAN, e.g. SQ operates SIN – BKK – KIX vv. In this case the airline provides valuable competition in the market to TG and JL who code-share on each others services. This type of 5th freedom operation is to be supported rather than limited, but it must be recognized that opportunistic use of 5th freedom rights may restrict the growth of 3rd and 4th freedom carriers.

TABLE 6-6-2. NON ASEAN CARRIERS – 5TH FREEDOM FLIGHTS WITHIN ASEAN

Route	Carrier	Aircraft	Weekly Frequency	Seats	Total Weekly Seats
JKT – SIN	UL	330	1	312	312
	GF	343	3	259 *	777
	CX	777	7	336	2352
	AF	777	3	270	810
	LH	744	7	390	2730
	KL	74M	7	260 *	1820
	EK	777	4	303	1212
	KU	340	3	280	840
	QF	763	3	239	717
	AI	310	3	220 *	660
JKT – KUL	EK	777	3	303	909
	QR	AB3	4	231	924
	IY	310	2	256	1024
DPS – SIN	QF	763	2	239	478
SIN – KUL	UL	330	5	312	1560
	JL	767	7	250	1750
KUL – MNL	KL	74M	5	260 *	1300
BKK – HAN	AF	343	2	252	504
BKK – HCM	AF	343	3	252	756
	LH	744	3	390	1170
BKK – MNL	MS	777	2	319	638
	KU	340	5	280	1400
	LH	744	7	390	2730
BKK – SIN	IC	320	7	140	980
	CX	343	7	249	1743
	TK	343	4	271	1084
	BG	310	4	221	884
	AY	M11	4	296	1172
	LX	M11	7	248	992
	SK	343	4	261	1044
RGN – BKK	KB	141	2	73	146
	BG	737	2	114	228
PEN – MES	CI	738	7	154	1078

* *Estimates*

Source: Official Airline Guide , Airline websites

Unrestricted 5^{th} freedom rights should be available within each of the suggested geographic groupings and the remaining bi-laterals should move just as quickly as the parties can reach agreement. Ideally this would occur in the first stage. For example, Philippines may be more willing to reach such an agreement with, say one country than another. Again the beyond ASEAN grant of 5^{th} freedom rights on an unrestricted basis is seen as an important but longer term step.

Foreign (Non-ASEAN Carriers Within ASEAN)

There are extensive 5^{th} freedom operations by non-ASEAN carriers between some ASEAN members (as noted above).

Bangkok – Singapore has a very large number of operations and seats by European carriers in particular, but also by others from the Middle East and India. These operations have provided extensive price, frequency and service competition in the historic context of single designations.

As ASEAN states develop new carriers and are able to use double and multiple designation, the public benefit deriving from 5^{th} freedom operations can be met by the new carriers. Whilst it is not proposed that any of these 5^{th} freedom rights be taken away, it may be that as new ASEAN carriers (LCCs or others) develop and that as more economical lower capacity aircraft are used to replace 747 type aircraft, that the use of intra-ASEAN 5^{th} freedom rights by non-ASEAN carriers may well reduce, e.g. a carrier now operating from a European point to BKK and SIN may replace that aircraft with non-stop services to each point using (e.g. an A.340-600 or a B.777-200).

ASEAN states are recommended to take no action but to consider carefully the grant of rights that may inhibit the growth of its own carriers. It is observed that there is some use of 5^{th} freedom rights by very small carriers such as Druk Air. These appear to be acceptable on political/equity grounds.

5^{th} Freedom Operations Partially Outside of ASEAN by Foreign Carriers

This situation also occurs: for example, British Airways operates from both Bangkok and Singapore to Australia (many other carriers including Emirates, Gulf Air and Lauda/Austrian, fly a similar route). The facts of geography and technical limitations of aircraft mean that this practice is essential. The negative element of these valuable rights is compensated for by the ability of the ASEAN carriers to conduct 6^{th} freedom operations between, say points in Australia and points in Europe. 5^{th} freedom rights in this case are subject to individual bi-lateral air service agreements and is again outside the scope of this study, however ASEAN member countries are urged to consider carefully the reciprocal opportunity for its carriers when granting new rights. The focus needs to be on building strong competitive air services.

7^{th} Freedom and Cabotage

Cabotage is not seen as being particularly relevant to ASEAN Open Sky and is not recommended as an appropriate policy initiative in the first three phases of movement to Open Sky.

7^{th} freedom operations are again not seen as a preferred liberalization policy option. It is considered that a liberal foreign investment policy together with a principal place of business test will bring about more significant investment and employment in the aviation sector whilst at the same time giving benefits of increased competition and market reach, than will 7^{th} freedom rights, however the grant of such rights is not opposed.

Market Competition Issues & Code-Shares

The question of code-share can be vexed: they are, prima facie, anti-competitive and create illusions. Consumers are confused, often not understanding which carrier they are to fly on board. There may however be some benefits from some code-shares, particularly when routes are thin and/or some of the participating carriers may be weak and lack the resources to undertake effective marketing.

There is however a clear view that code-shares on primary city-pairs should be prohibited. It is surprising to find that there are a number of primary route code-shares between national carriers present within so called open skies agreements. Two examples are Ho Chi Minh to Manila and vv, and another (particularly surprising) one is the recently announced Royal Brunei/Singapore Airlines code-share between Bandar Seri Begawan and Singapore. In neither of these cases is there any multiple designation or 5th freedom carrier to provide competition.

These non-competitive code-shares should be eliminated by the end of the first phase, however where there is 5th freedom competition on the route, they may be continued into the second phase, but should be eliminated before the end of the second phase. No new code-shares should be introduced on primary city-pairs even where there is extensive existing code-sharing or 5th freedom operations.

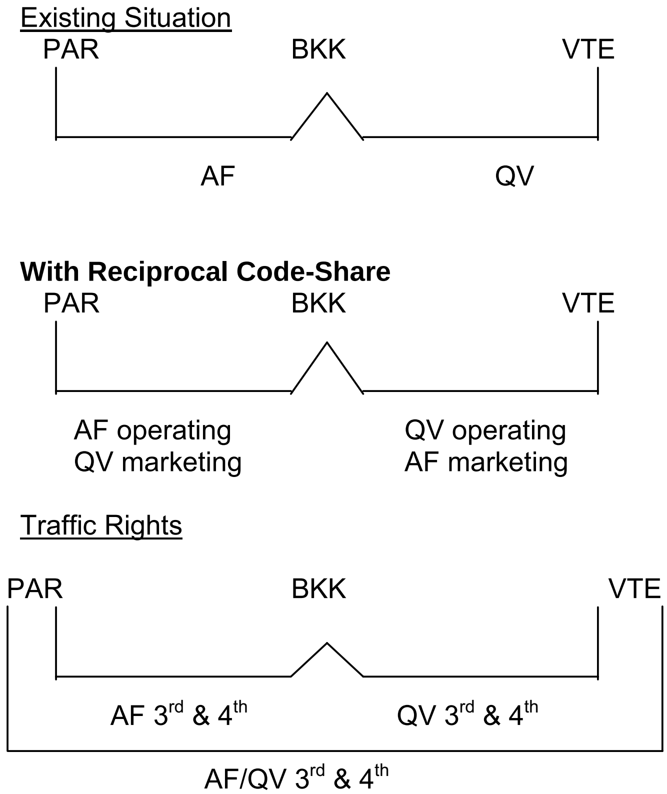
There are a number of examples of code-shares with non-ASEAN carriers on extra ASEAN routes but no examples were identified on code-shares on ASEAN routes between ASEAN carriers and non-ASEAN carriers.

Code-sharing may have a value where it leads to route expansion, i.e. where one carrier does not fly the route at all, but as a marketing carrier gives the appearance, but not the reality of having the destination point on its network. These advantages are largely intangible and are marketing related. There is however one more concrete advantage and that relates to the special pro-rate of the sector fare which is often co-extensive with a code-share. A Special Pro-rate (SPA) enables non-operating carriers to provide fares which are competitive. Without the special pro-rate the inter-carrier fare could be as high as the full sector but is more likely to be a straight rate pro-rate, i.e. distance related.

Code-Shares within Non-ASEAN Carriers

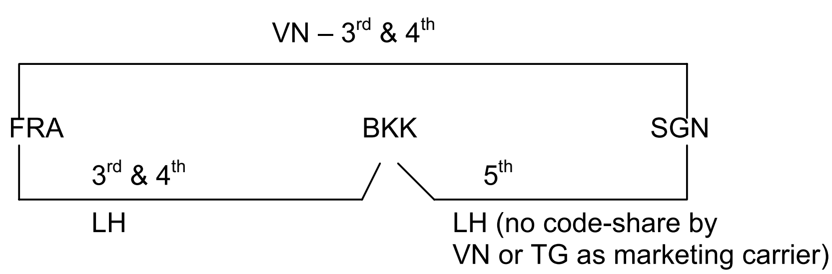
There may be a case for this type of code-share to be allowed if the code-share is reciprocal. A smaller ASEAN carrier may gain some benefit by being the operating carrier to a major ASEAN hub airport from a point in its state of designation, then being the marketing carrier on a long haul European carrier. In reverse the long haul European carrier is the operating carrier to the ASEAN hub and the marketing carrier from the ASEAN hub to the ASEAN end destination. Approval for this type of code-share should not however extend to the apparent grant of 5th freedom rights which do not exist and the code-share should not be used to convey any impression that rights exist where they do not.

Figure 6-6-2. Illustration of Reciprocal Code Shares with Non-ASEAN Carriers



The approval for code-shares with non-ASEAN carriers should be limited to the circumstances described above. There should be no code-shares with long haul carriers on 5th freedom sectors within ASEAN, even though alliance participation may point carriers in that direction.

Figure 6-6-2. Illustration of Code Shares Not Permitted with Non-ASEAN Carriers



Time Frame for Code-Share Limitations
It is quite difficult to ask airlines to unwind established commercial relationships, however over time, these relations do change. There has been change in the alliance participations and changes in cross-alliance arrangements, as well. The following time-scale is proposed for code-share rationalization:

TABLE 6-6-2 TIME SCALE FOR CODE-SHARE RATIONALIZATION

In Phase 1	∉ No new 'prohibited' code-share ∉ No change of code-share partners on a route
Beginning of Phase 2	Continuing code-shares on primary routes to be terminated during Phase 2 plus new evaluation of need for code-shares on routes

Code-Shares & Transparency
Carriers and the distribution network have a clear obligation to advise consumers of all aspects of any permitted code-share, the consumer is entitled to know the airline name, its place of designation, the aircraft type, the configuration and any other generally publicly available information. This will, in most cases, require some national regulation, this can be achieved by imposing an appropriate condition at the time of schedule approval.

Code-Shares & Capacity
Where a code-share is seen as an appropriate way to develop thin and/or new routes, there is an issue of capacity. The notion of code-share capacity needs to be separated from operating capacity. Some carriers have been reluctant to enter into code-share arrangements to support thin/new routes as the seats used on the code-share have been taken from the agreed operating capacity on principal routes. Of course, this is not a problem if the $3^{rd}/4^{th}$ freedom capacity is unlimited but until such time as that occurs, ASEAN countries should, on a bi-lateral basis, negotiate very generous code-share capacity which exists along side operating capacity and not in substitution for it.

Gateway Access
In Phase 1 of reform every ASEAN country should enter a sub-regional multi-lateral or bi-lateral aviation relationship with every other country so that primary gateway access becomes available.

Such gateway access would ideally be on an open (unlimited) capacity basis, however where that is not achievable, it is important that secondary gateway capacity should not be deducted from primary gateway capacity. Secondary gateway capacity is often made available on a far more generous basis than is ever taken up but where it is taken up, it is supplemental to any limited primary gateway capacity, not deducted from it.

Code-shares may be permitted on secondary gateway routes.

Declaration of Gateways
The declaration of a point as a gateway is entirely a domestic matter for each state. There should be no assumption that because there is an airport capable of handling an aircraft in scheduled service that the state in which the airport is located must provide CIQ facilitation and declare the airport to be international and thus an available gateway.

Ground Handling

The key element in relation to ground handling is the freedom to choose one's own handling method. The broad options are:

1. Self-handling
2. Other airline handling
3. Independent non-airline handler.

Some carriers opt for the public contact areas to be self-handling (so as to reinforce their commercial image) but contract all other aspects out to one or more (often multiple) contractors.

Other airlines are often used as the handling agent, particularly within an alliance, however examples of cross or non-alliance handling contracts are observed. Within ASEAN there are at least 2 cases where BOT providers of airport terminals have negotiated monopoly provision of handling arrangements for a period of 20 years (the length of the BOT contract). Whilst this arrangement may have facilitated the construction of the terminal etc, it is anti-competitive. It is recognised that it may not be possible to break these agreements without incurring substantial penalties but 2 courses of action should be adopted. Notice should be given that the exclusive contract for handling will not be renewed and that at the half-way point of the current contract, there should be a negotiation leading to self-handling for a carrier who so chooses. The second course of action should be the introduction of price monitoring (involving collection of price data and assessment in terms of how reasonable prices are) and if necessary, pricing control. A monopoly service provider should not be allowed to price in such a way that air service is discouraged.

In cases other than BOT contracts, it is seen that self-handling should be an option at all airports in Phase 2 and 3rd party handling an option in Phase 3. It is of course recognised that some lesser gateways may have too few movements to support multiple optional handling arrangement, but it remains important that the opportunity for alternative arrangements be present.

'Doing Business'

The 'doing business' restrictions identified are not exhaustive, however they are ones that were identified or are common in other regions. It is thought that there could be an early introduction if the removal of 'dong business' restrictions. It is understood that some of these are beyond the scope of Transport/Civil Aviation authorities, for example, the transfer of staff may involve the immigration agency and the transfer of funds may involve the central bank. The appointment of a GSA should not be prescribed (as it usually is in the Middle East) and it should be left to the commercial discretion of the carrier as to the conduct of its own business activities. As additional 'doing business' restrictions are identified they should be slotted into the reform agenda. In the second phase all 'doing business' restrictions should be eliminated.

Charters

As is observed elsewhere, in Europe the distinction between charters and scheduled service has been removed. It is proposed that within ASEAN for ASEAN airlines, the same policy be adopted i.e. that charters be treated as if they were scheduled flights. Until all countries have open capacity regimes with all other countries, applications will still be required for so-called "extra sections". The maintenance of the distinction between charters and scheduled services is artificial and inappropriate in an 'open sky' context.

Charters from non-ASEAN countries should continue to be handled on an application basis. Whilst charters, especially inclusive tour charters (ITC) are usually important contributors to tourism, charters can, when operated over scheduled service routes, sometimes be deleterious to the sustainability of the scheduled route and some destinations prefer continuing scheduled service to seasonal charters. The ideal solution is to accommodate both. The elimination of the distinction should occur in the first and/or second phase.

Scheduled Cargo

There have been considerable concerns expressed about the role of the 'integrators' in air cargo in the ASEAN region. These operators, especially the large US based ones such as FEDEX and UPS have taken a considerable amount of the small consignment traffic that scheduled carriers have traditionally put on board scheduled passenger aircraft. It is outside the scope of this report to deal with the reported problem, however there is an important aspect of liberalization and it is that the liberalization of air cargo within ASEAN may well create the context for a credible commercial response. The cessation of continued grant of 5th freedom rights within ASEAN to non-ASEAN carriers could give the ASEAN carriers some time to create their own commercial response.

Is it possible that there could be an 'ASEAN integrator' created, with unlimited rights within ASEAN and extending beyond ASEAN with generous 5th freedom rights. The 'ASEAN integrator' could be funded and developed by a consortium of ASEAN owned airlines, freight forwarders and ground service providers.

Non-ASEAN cargo carriers should have all the access that is appropriate for export market development and import of capital and other goods. This will most probably continue to be dealt with on a bi-lateral basis.

7. IMPACTS OF POLICIES: BENEFITS AND COSTS

7.1 Introduction

In this chapter, we examine the ways in which individual policy options impact on the objectives a country is pursuing. Objectives are translated into various benefits and costs, or gains and losses, which are examined in the next section. After this, an outline of how different countries fare under the policy options based on their individual circumstances is presented. The concept of a “Policy Options/Objectives Matrix” is then introduced. The ways in which the different policy options impact on objectives will then be analysed, enabling the cells of the matrix to be filled in. The chapter concludes with examples of how specific policy options might be examined from the viewpoint of a particular country.

7.2 Country Objectives, Benefits and Costs

When dealing with aviation policy, countries have various objectives. In particular, they have various economic objectives, as well as non-economic objectives. It is possible to look at different policy options in terms of how they advance these objectives.

For present purposes, it is useful to look at these objectives in terms of benefits and costs or gains and losses. Thus a country will seek to gain benefits and avoid costs. It will have the objective of increasing benefits to its consumers/ travellers, and of increasing the profitability of its airlines. It may have the objective of job promotion, or of increasing its holdings of foreign exchange. Associated with these objectives, there are corresponding benefits and costs. If a policy leads to additional foreign exchange receipts, there will be a foreign exchange benefit, and the foreign exchange objective will be enhanced. Thus, following on from Ch 5, we identify a number of economic benefits and costs. Each policy option, or package of policy options, can have an impact on each of these benefits or costs. In this section, the benefits or costs are outlined, and ways in which they can be measured, at least in general terms, will be suggested.

In air transport, the two most important sources of benefits or costs are the most direct ones. They are the benefits that accrue to the users of the air transport, the passengers or shippers, and the benefits that accrue to the producers, mainly the airlines. There are other categories of benefits or groups of beneficiaries, but experience shows that the benefits accruing directly are by far the largest.

7.2.1 Direct Benefits and Costs

Benefits to Travellers/Consumers

The users of air transport will gain or lose as a result of the implementation of policy options. If implementing an option results in lower fares, the travellers gain a benefit. If an option results in lower frequency of service, the travellers will face a cost. In the main, travellers will gain a positive benefit from lower prices, given other factors such as quality remaining constant. They will also gain if the product mix is improved, and choice is widened - for example, when lower, cost based fares become available. They will gain when frequency increases, perhaps as a result of a route becoming busier. They will gain if the quality of service is improved.

A country will gain to the extent that its nationals enjoy these benefits. Fare reductions which accrue to home country nationals imply a benefit for the country. Fare reductions which accrue to nationals of other countries do not directly benefit the home country (though if they are tourists, additional tourism may be a benefit for the country). Some of the benefits accrue to leisure travellers, who are travelling for their own reasons, such as to have a holiday. When business travellers enjoy lower fares, they may not personally gain, but their employer will gain; the country's industry will be the beneficiary. This will lead to lower prices for goods in the country, or higher profits for the country's industries.

The benefits from a policy change which accrue to travellers are usually fairly straightforward to estimate, partly because they are direct.

Benefits to airlines and other producers
Policy options can impact on airline profits. If they reduce yields, they reduce profits - to this extent they have a cost. Policy options can also reduce costs for the airline, and other things equal, this would deliver a benefit to them. Competition tends to impose a cost on firms, since it forces prices, and thus profits, down. This will be mitigated to the extent that the firm is able to reduce costs through greater productivity. If productivity is enhanced, the gain to travellers from the lower prices will be less than the reduction in profits to the airline.

The airline itself may not be the only producer to be affected by policy options. It may be that its workforce shares in its profits, through higher wages and easier working conditions. Thus, when a policy makes it more difficult for an airline, it may pass on some of the profit loss by paying its workers less, or getting them to work harder. This has happened with several of the crises that ASEAN airlines have had to face in recent years- it has not only been airline profits which have suffered.

From the home country's perspective, when its airlines profits fall, the country itself faces a loss of economic welfare. This supposes that the airline is owned by its nationals. To the extent that airlines are foreign owned, any benefits or costs faced by them are shared with the foreign owners. Likewise, most of the workforce of a country's airlines will be nationals - however not all of them will be, and so when an airline and its workforce suffers under a policy, some of the loss will be experienced by non nationals.

The impacts on profits and wages of a policy change are direct impacts, and they are normally straightforward to estimate.

7.2.2 Indirect Benefits and Costs

Inbound Tourism
A policy option may have an impact on fares, and this can alter flows of inbound tourism. Suppose that a policy has the effect of reducing fares. This benefit is enjoyed by foreign tourists, and thus it cannot be regarded as a benefit for the country. However, when lower fares lead to more tourism to the country, the country may gain. Additional tourism receipts and activity may be a positive effect for the country. The full amount of the receipts would not be an accurate measure of the gain, because the tourists must be supplied with goods and services, which have a cost. However, the industry may make profits out of the tourists, and the government is likely to tax some of the things the tourists buy. Thus it costs less to supply the tourists than the revenue they generate, and the country, as a whole gains. While the benefit to a country of a 10% fare reduction which accrues to foreign visitors is not as great as the same reduction when it accrues to its own nationals who are travelling, there will still be a significant benefit to the country from the impact on its tourism industry.

Outbound Tourism
A policy option may impact on outbound tourism. For example, a fare reduction may induce a country's citizens to take outbound trips. As consumers of air services, they, and the country, gain - however, there will be some cost, because of the negative impact on economic activity and the possible negative impact on the country's tourism industry. Outbound trips are taken as a substitute for domestic tourism and expenditure on other goods and services at home. Thus there is a cost associated with an increase in outbound tourism; this is very likely to be

much less than the gain to the country through the benefits enjoyed by its travellers from the lower fares.

Foreign Exchange Benefits

There may be a benefit to a country if a policy results in increased earnings of foreign exchange. This will be the case if its currency is undervalued by the market or official exchange rate. If the economy has a flexible exchange rate, and it does not have many large trade distortions in place, then the market exchange rate will be a good reflection of the currency's worth.

By contrast, where there are large trade distortions (tariffs, quotas, export taxes etc) present, or where the official exchange rate is set at an arbitrary level, the official rate may be an inaccurate measure of the currency's worth. If the currency is overvalued, additional foreign exchange is undervalued; thus there is a benefit to the country in gaining additional receipts.

This could be a relevant consideration for airline policy for a country. In principle it would be possible to estimate the size of this benefit, though in practice it would be complex. The impact on foreign exchange receipts would need to be calculated - this would depend on the impact of the policy on tourism flows, airline purchasing and other variables. The true value of the exchange rate would also need to be estimated.

Government Revenue

For many countries, there are taxes on both aviation (eg fuel taxes) and tourism (eg bed taxes). In addition, there are general taxes on other goods and services tourists buy. Airline profits may be taxed. Governments also subsidise some activities. Thus when aviation policies alter aviation and tourism activity, tax receipts can change. In short, some of the benefits or costs of policy options may be converted into government revenue increases or reductions - governments and taxpayers share the benefits and costs.

In addition to this, it should also be noted that some changes result in increased spending by governments. Thus additional tourism may necessitate greater spending by the government on infrastructure to provide for it.

The net impact on government revenue can be estimated, though it is not easy to do this, given the complexities. If some taxes and subsidies are large, and obvious, it may be possible to estimate the revenue effects fairly readily.

Employment Benefits

For some countries, increasing employment is a policy objective, because of the existence of unemployment. Aviation policy changes can have an impact on employment, through its effect on economic activity. More aviation and tourism economic activity will stimulate employment.

The effects of changes such as aviation policy changes, are usually difficult to estimate, granted the complexity of the markets which are affected, such as the labour market. Even when there are direct and positive effects on employment, one should be cautious about assuming that there will be a large positive net effect, because offsetting forces can come into play.

Skills Development

People learn by doing, and experience in doing jobs assists skills development. Having industries, such as aviation and tourism, creates a demand for skills, but it also fosters skill development by giving people an opportunity to learn. The impact of a policy option on skill development is very difficult to measure but it is likely that it would be in proportion to that policy options impact on economic activity in general.

Costs of Risk
The reliability and predictability of air services is important in most economies. Disruptions such as cancellations of services, sudden closures of routes and airline failure are costly. These costs are borne by travellers generally, but most importantly by businesses, which put a premium on reliability. A reduction in the reliability of air services to and from a country will spread costs across its economy generally. While it is very difficult to quantify the costs of this risk, it should be recognised as a factor when considering policy options.

Business Development and Communication
When business travellers enjoy an improvement in airline services though an increase in frequency or a fall in fares, the business which employs them will gain. There may, however, be some positive effects on business more broadly in the economy. Lower communications costs result in more efficient economies, and greater opportunities from specialisation or scale economies. Opportunities for trade are enhanced. It would be very difficult to assess how large this benefit would be, but it is a factor which can be given some recognition in determining policy options.

Non-Economic Effects
Aviation policy options will have impacts on non economic aspects of countries. Changes in aviation can impact on defence and security, on health and safety, and on the environment. There may be some foreign policy dimensions to aviation policy. These aspects are recognised, but not developed here. They are best analysed by those expert on them.

7.3 How Different Countries Fare under the Policy Options

Countries in the ASEAN region differ, and as a result, a particular policy option can have very different impacts on them. It is important to highlight these, so that they can be borne in mind in discussion of the benefits and costs of the policy options

7.3.1 Proportion of home country travellers on air services

For some countries, the proportion of travellers on its international air services who are nationals is very high (beyond the ASEAN region, the proportion can be higher than 90%). For others, this proportion can be low.

When the proportion is high, most of the benefits from improved air services accrue to the home country - its citizens gain most of the savings from fare reductions. By contrast, where the proportion is low, few of the benefits from improved air services accrue to it. The former country will tend to be in favour of lower fares, and any policy options which will help secure this outcome; the latter country will be much less interested in low fares, at least directly.

7.3.2 Home country airlines' share of the traffic

The proportion of traffic which is carried by the home country's airlines may vary quite widely from country to country and route to route. Sometimes, most of the traffic to and from a country is carried by other countries' airlines. If this is so, then most of the profits and producer benefits (including benefits to the workforces of the airlines) accrue to countries other than the home country. The reverse will be the case when the home country's airlines carry much of the traffic.

7.3.3 Home country ownership of airlines

The ownership of a country's airlines may be local or foreign. Where there is a high proportion of foreign ownership of an airline, any profits which accrue to it will be due to other countries. To this extent, such a country may be less interested in increasing airline profits.

7.3.4 Patterns of tourism flows

When a high proportion of the travellers on a country's air services are its nationals, there must necessarily be a correspondingly low proportion who are visitors. To this extent, air services are patronised by outbound tourists rather than inbound tourists. When air fares are reduced, the impact on outbound tourism could be quite large, but the impact on inbound tourism quite small. The home tourism industry may prefer to see high rather than low air fares, because these will be a disincentive to international travel, and it may encourage domestic tourism.

7.3.4 Foreign exchange

For some countries, foreign exchange earnings are not an issue. Countries with flexible exchange rates and few trade distortions will not be concerned about foreign exchange earnings. By contrast, other countries with managed exchange rates and extensive trade interventions may face a shortage of foreign exchange, and may be very concerned about foreign exchange implications of policy options.

7.3.5 Employment and skills development

The importance of these issues will differ from country to country according to their circumstances.

7.3.6 The ASEAN Perspective

Policy options which are positive for one country in ASEAN need not be positive for its partner countries. Thus one country's travellers may gain from lower fares on a route, while the other country's airline may lose out because it earns lower profits. It will be necessary to take a perspective from the viewpoint of ASEAN as a whole, as well as from the individual countries.

Furthermore, the net benefits from particular policy options could be positive for some countries in ASEAN and negative for others. It need not be the case that a particular policy option, such as opening up new gateways, would give positive net benefits for all countries- some might lose. How specific liberalisation options impact on individual countries depends on their specific circumstances, as has been noted above. While ASEAN members as whole are likely to gain from the policy options, individual countries could lose.

It needs to be recognised that some of the benefits and costs of policy options will accrue to non ASEAN nationals. Tourists from outside ASEAN will gain from lower fares, and non ASEAN airlines flying in the region (eg on a 5th freedom basis) will be affected by the policy options. There may be some impacts on ASEAN countries- for example, lower air fares enjoyed by tourists will lead to more tourism to ASEAN countries from outside ASEAN.

In summary, the benefits and costs from the policy options considered in this chapter should be considered from the viewpoint of the countries affected, but they should also be considered from an overall ASEAN perspective.

7.4 The Policy Options/ Objective Matrix

The Policy Options/ Objectives Matrix is a framework which shows how the various policy options under review can impact on the objectives. It can be interpreted as follows.

Consider a policy option, such as introducing multiple designation. The ways in which this will impact on the different objectives is shown in the cells of the matrix. Thus, because of additional competition, multiple designation may lead to positive benefits for passengers. This is indicated as a “+” in the matrix. This impact on airline profits will be negative, because profits will fall because of increased competition - this is indicated in the matrix by “-“. The impact on foreign exchange earnings may be indeterminate - shown by “?”. Where an impact is minimal, it is shown as “0”. Finally, the impact on an objective or source of gain or loss may depend critically on the circumstances facing the country - this is illustrated in the matrix by “K”. With additional information about the country, it would be possible to tell whether the impact is positive or negative.

Thus far, the various policy options have been outlined in Ch 6, and the objectives or sources of gain and loss have been outlined in the previous section. To fill in the matrix, it is necessary to determine how each option is likely to impact on the sources of gain or loss. This is done in the next section, which then enables the Matrix to be filled in.

TABLE 7-4 POLICY OPTIONS/OBJECTIVE MATRIX (HOW POLICY OPTIONS IMPACT ON OBJECTIVES)

Objective/ Policy Option	Passenger Benefits	Airline Profits	Inbound Tourism	Outbound Tourism	Government Revenue	Foreign Exchange	Employment/ Skills	Risk	Business Communications
Fare Liberalisation									
Multiple Designation									
Liberalise Capacity									
Grant Gateway									
Gain Gateway									
Allow Charters									
Gain Charters									
Enhance Competition									
Gain Code Share									
Grant Code Share									
Gain 5th, 7th, Cabotage									
Grant 5th, 7th, Cabotage									
Liberalise Ownership									
Liberalise Ground Handling									

Code:

+ Positive Impact
- Negative Impact
? Indeterminate Impact
0 Minimal Impact
K Depends on Country Circumstances

7.5 How the Policy Options Impact on Objectives: Benefits and Costs of Individual Policy Options

In this section, the question of how the different policy options impact on the objectives a country might have is examined. What benefits and costs for a country will be associated with the implementation of the policy options? Any attempt to examine Open Sky as a whole will need to look at the individual components, the specific policy options, not simply the options grouped in stages or packages. How each option, such as moving to Multiple Designation, will impact on a range of aspects, such as traveller benefits, airline profits, tourism, risks etc will be considered here. What will be discussed here is the broad pattern for all countries- the exact implications for any individual country will depend on the individual country's circumstances. For example, a country will not gain much by way of traveller/consumer benefits if it generates very little outbound traffic.

7.5.1 Fare Liberalisation

This could mean moving to Double Disapproval, or removing fare regulation entirely. Liberalisation of fares means that airlines will be able to compete more on fares, and introduce new fares such as low cost "no frills" fares.

Direct Benefits and Costs

- Passengers will gain from lower fares;
- Airlines will lose from greater competition squeezing profits. The loss will be less than the gain to passengers where airlines can reduce costs, or where the lower fares are cost based (e.g. new fares not previously offered).

Indirect Benefits and Costs

- Both outbound and inbound tourism will increase; the net effect will depend on the country. There will be a gain if the country's tourism industry enjoys a net expansion;
- There will be no clear impact on government revenue, though it could fall slightly if airline profits are taxed, because the tax base will shrink;
- Foreign exchange impacts are indeterminate;
- Employment opportunities will increase when there is a net increase in inbound tourism. Skills development will also be affected positively in this case;
- Risks may increase slightly;
- Business development will be enhanced by the wider choice of lower fares.

7.5.2 Liberalising Designation

Designation can be liberalised by moving to multiple designation, or by removing controls on the number of airlines which may serve the route. There will be stronger competition between carriers, and fares will fall somewhat. New more efficient carriers may enter putting downward pressure on cost.

Direct Benefits and Costs

- Passengers will gain from lower fares and increased choice of airlines and perhaps routes;
- Established airlines will lose profits to the extent that they face more competition. To the extent that they reduce their costs they will moderate the reduction in profits;
- New entrant airlines will gain from opening up of new opportunities. On balance, airline profits will probably fall, though not by as much as the gain to passengers.

Indirect Benefits and Costs

- Inbound and Outbound tourism will both increase with lower fares - the balance depends on country circumstances;

- Government revenues will be negatively affected to the extent that profits which are taxed fall, and will be positively affected to the extent that the tourism industry grows;
- Foreign exchange effects are indeterminate;
- Employment and skills opportunities will depend mainly on the impact on the home tourism industry;
- The risks of doing business generally will fall due to there being more choice of carriers, but the carriers themselves may face more risks due to increased competition;
- Business development will be enhanced by lower fares and greater choice of airlines and networks.

7.5.3 Capacity Increases

These could come about as a result of capacity becoming completely deregulated, or as a result of allowable capacity being increased within a regulated system. Increased capacity will lead to lower fares and pressure on costs if the number of competitors is regulated. Where it is not, there will be scope for new airlines to enter, increasing pressure on costs.

Direct Benefits and Costs

- Passengers will gain from lower fares;
- Airlines will normally lose as a result of greater competition and lower fares, but they could gain if capacity has been very tightly restricted. Costs will tend to fall, resulting in the negative impact on airlines being less than the positive effect on passengers.

Indirect Benefits and Costs

- Inbound and Outbound tourism will increase, the balance depending on the country;
- Government revenue, to the extent dependent on airline profits, will fall, but will increase if the home tourism industry expands strongly;
- Foreign exchange impacts are indeterminate;
- Employment and skills opportunities will improve due to airline and tourism industry expansion;
- Risks as faced by airline will increase, but the greater choices will lessen risks for other business;
- Business development will be enhanced due to lower fares and more flights.

7.5.4 Allowing Additional Gateways to Partner Countries

Under this option, secondary gateways are opened up to airlines of other ASEAN countries, and their airlines operate direct services to these gateways, lowering costs of access to them.

Direct Benefits and Costs

- Passengers will gain to the extent that they take advantage of the new exit point from the country;
- The home airlines may or may not face additional competition (depending on whether they serve the gateway, and whether new services compete with their services or not). Impacts on profit from opening secondary gateways should be small. Domestic airlines will suffer some loss of connecting traffic.

Indirect Benefits and Costs

- Inbound tourism is likely to increase and outweigh the rise in outbound tourism;
- The impact on government revenue is likely to be positive if the tourism industry grows strongly;
- Foreign exchange receipts are likely to grow if tourism expands;
- Employment and skills development opportunities are likely to increase;

- Risk effects are likely to be minimal;
- Business development will be positively affected.

7.5.5 Gaining Additional Gateways form Partner Countries

Under this option, a country's airlines are enabled to operate direct services to secondary destinations in another country.

Direct Benefits and Costs

- Home country passengers will gain from the new direct services, which will cut the cost of travel to secondary destinations;
- The country's airlines will gain additional profits from obtaining increased market access;

Indirect Benefits and Costs

- Outbound tourism is likely to increase more than inbound tourism, though not always (this depends on the countries in question);
- The impact on government revenue is indeterminate;
- Foreign exchange receipts are likely to fall if there is a boom in outbound tourism;
- There is not likely to be a clear effect either way on employment and skills opportunities;
- There will be minimal impacts on risks;
- Business development will positively affected.

7.5.6 Allow Charters

Similar impacts to additional gateways

7.5.7 Enhance Market Competition/ Restrict Anti Competitive Alliances

Similar impacts to multiple designation

7.5.8 Gain Code Shares on Non Competing Routes

Home country airlines are permitted to code share on routes beyond their borders.

Direct Benefits and Costs

- Passengers gain from convenience;
- Airlines gain from increased demand, lower operational costs.

Indirect Benefits and Costs

- Inbound and Outbound tourism will both increase slightly;
- Other impacts are likely to be minimal.

7.5.9 Grant Code Shares on Non Competing Routes

Airlines form other ASEAN countries are permitted to code share on routes to and from the home country.

Direct Benefits and Costs

- Passengers will gain from convenience;
- Home country airlines may face a little stronger competition.

Indirect Benefits and Costs

- Inbound and outbound tourism will increase slightly;
- Other impacts are likely to be minimal.

7.5.10 Gain 5th or 7th Freedom Rights or Cabotage

Under this option, the home country airline gains the right to operate 5th freedom flights, or 7th freedom flights elsewhere in ASEAN, or to operate entirely within other ASEAN countries.

<u>Direct Benefits and Costs</u>

- Passengers will gain, though the effect will only be large if they travel frequently on the routes which are affected;
- Airlines will gain form improved market access.

<u>Indirect Benefits and Costs</u>

- Tourism to and from the home country will not be affected much;
- Government revenue may increase slightly;
- Foreign exchange earnings may increase slightly;
- There may be a small increase in employment and skills opportunities;
- Risks will be little affected;
- Business will be positively affected by increased convenience.

7.5.11 Grant 5th or 7th Freedom Rights or Cabotage

Under this option, airlines from other countries will have more scope to operate from or within the country.

<u>Direct Benefits and Costs</u>

- Passengers will gain from lower fares and better networks;
- Home country airlines will face more competition, and will face profits reductions, though these will be less than the gain to consumers since costs are likely to fall;

<u>Indirect Benefits and Costs</u>

- Both inbound and outbound tourism will be increased;
- Government revenue may fall sightly unless there is a large increase in inbound tourism;
- Foreign exchange impacts are likely to be slightly negative;
- Employment and skills opportunities are not likely to be much affected;
- Risks are not likely to be much affected;
- Business will be positively affected.

7.5.12 Grant or Gain Additional Air Freight Gateways

The pattern of benefits and costs for these options are comparable to those for granting or gaining additional passenger gateways, with passenger gains being replaced by shipper gains.

7.5.13 Ownership Liberalisation

This will lead to improved access to finance and managerial skills for home country airlines, which can be expected to become more productive and to assist new airlines starting up. Airline costs should fall.

<u>Direct Benefits and Costs</u>

- Passengers should gain if the industry becomes more competitive;
- Airlines will gain because their costs will fall, and they will not be forced to pass all the cost savings on to passengers;

Indirect Benefits and Costs

- To the extent that fares fall, inbound and outbound tourism will be stimulated;
- Government revenue will increase to the extent that airline profits are taxed;
- Foreign exchange receipts will increase to the extent that stronger airlines are able to capture a larger share of traffic;
- Employment and skills opportunities will increase to the extent that the airline industry is stronger;
- Risks will be reduced granted the improved financial stability of the airlines;
- Business will gain from better and more reliable air services.

7.5.14 Liberalisation of Ground Handling

This will enable more competition and trade at the ground handling level. More competitive ground handling, and opening up ground handling to experienced operators from other ASEAN (or non ASEAN) countries will lower costs to airlines, and improve reliability by lessening the reliance on one or a few firms.

Direct Benefits and Costs

- Passengers will gain a little if competition forces airlines to pass on some of the savings;
- Airlines will gain from lower costs and improved efficiency of ground handling;
- Existing ground handlers will lose to the extent that they face more competition, but they may be able to limit these losses by improving efficiency.

Indirect Benefits and Costs

- Inbound and outbound tourism will increase though not by much;
- There are unlikely to be significant impacts on government revenue or foreign exchange receipts;
- Risks will be reduced through having more reliable ground handling;
- The impact on business will be positive but small.

7.6 Completing the Policy Options/Objectives Matrix

With the discussion in the section above, it is possible to fill in the cells of the Matrix. The various effects on the objectives, or categories of gain and loss, have been suggested. The matrix, as completed, provides a summary of these impacts.

For example, to see the impacts of fare liberalisation, consider the first row of the Matrix. The impact on passenger benefits is positive, but the impact on airline profits is negative. Both inbound and outbound tourism are stimulated. It is difficult to determine the impact on government revenue, and the impact on foreign exchange earnings varies form country to country. There are likely to be positive effects on employment, skills development but risks are also likely to rise. It will have a positive effect on business communications.

TABLE 7-6 COMPLETING THE POLICY OPTIONS/OBJECTIVE MATRIX (HOW POLICY OPTIONS IMPACT ON OBJECTIVES)

Objective/ Policy Option	Passenger Benefits	Airline Profits	Inbound Tourism	Outbound Tourism	Government Revenue	Foreign Exchange	Employment/ Skills	Risk	Business Communications
Fare Liberalisation	+	-	+	+	?	K	+	+	+
Multiple Designation	+	-	+	+	?	K	K	+	+
Liberalise Capacity	+	-	+	+	-	K	+	0	+
Grant Gateway	+	0	+	0	-	+	+	-	+
Gain Gateway	+	+	0	+	+	-	-	0	+
Allow Charters	+	0	+	0	-	+	+	-	+
Gain Charters	+	+	0	+	+	-	-	0	+
Enhance Competition	+	-	+	+	?	K	K	+	+
Gain Code Share	+	+	0	+	0	0	0	0	+
Grant Code Share	+	0	0	+	0	0	0	0	+
Gain 5th, 7th, Cabotage	+	+	0	0	+	+	+	0	+
Grant 5th, 7th, Cabotage	+	-	0	0	-	-	-	0	+
Liberalise Ownership	+	+	+	+	0	+	+	-	+
Liberalise Ground Handling	+	+	0	0	0	0	+	+	+

Code:

+ Positive Impact
- Negative Impact
? Indeterminate Impact
0 Minimal Impact
K Depends on Country Circumstances

7.7 Using the Framework

The framework, as presented so far, does not tell us whether or not a country gains from implementing a specific policy option, or a package of options. As noted, the benefits and costs to a country of a specific option depend critically on the country's circumstances- the various country specific factors which would matter are outlined in section 7.3. To show how the framework can be used to determine how a country fares, some hypothetical cases are given here.

Case 1: Liberalising Capacity between Two Countries

Suppose that capacity is liberalised between two countries. It might be liberalised completely, or the capacity scheduled might be increased. There might be scope for additional airlines from the two countries to enter. Suppose that much of the traffic on the routes affected is from the two end countries, and that country A provides a greater proportion of the passengers than country B. Suppose also that country A's airline has more than 50% of the capacity.

More capacity between the countries will lead to more intense competition, and pressure to lower fares. It may result in new carriers, perhaps low cost carriers entering. This will add to the competitive pressure, and it will put pressure on costs. The incumbent flag carriers will strive to reduce their costs somewhat.

The impacts on aspects of gain and loss will be as follows:

- Passengers. There will be significant gains to passengers, with the greater share going to country A's passengers.
- Airlines. Some airlines will lose out, though the loss will be moderated to the extent that they are able to reduce costs. New airlines will gain from being able to access markets and profit opportunities. Overall, the loss to the airlines will be smaller than the passenger gain. They will be greater in country A than B.
- Inbound Tourism. There will be increased inbound tourism to both countries, but B will be the main beneficiary.
- Outbound Tourism. The increase in outbound tourism will be greater for A, and so the negative impacts on domestic activity will be greater for A.
- Government Revenue. No clear effects.
- Employment and Skills Development. Granted that B experiences a net gain in tourism, it is likely that the effect will be positive for B and slightly negative for A.
- Risks. The flag carriers of both countries will face increased risk due to facing more competition.
- Business Communication. There will be improved conditions due to better communications between the two countries.

Overall, both countries will gain on balance. Probably A, with a greater share of the passengers, will gain a greater share of the direct benefits, but B, with an increased in inbound tourism, will enjoy a greater share of the (smaller) indirect benefits.

Case 2: Liberalising Capacity on an Unbalanced Route

Suppose a situation whereby there are capacity restrictions on a route between two countries, but that traffic on this route is unbalanced in the sense most of passengers come from country A, but countries A and B have equal shares of the capacity. The route is currently restrictive and profitable. Will both countries gain?

Consider the situation from the perspective of country B. More capacity will enable greater competition, and fares will fall. Costs may also fall, but not to the same extent. Liberalisation will mean that it faces a direct loss from lower airline profits. Its own passengers will gain a little, but since they are only a small proportion of total passengers, their gain is likely to be significantly less than the loss faced by the country's airlines.

This loss could be made up by indirect benefits, such as those from additional inbound tourism. In general, however, tourism benefits are likely to be significantly smaller than direct benefits to passengers and airlines. Hence it is quite probable that these would not outweigh the lost profit suffered by the airlines. On balance, this country would lose from capacity liberalisation. Effectively, this country had been in the fortunate position of charging its partner country's passengers high prices to travel on its airline.

By contrast, the other country would gain, because the savings to passengers would be much greater than the reductions in profit suffered by its airlines. A relevant question is why this country would have agreed to capacity limitations granted that it is its passengers who suffer from them.

This example shows that liberalisation is not necessarily in a particular country's interest. While ASEAN member countries as a group will gain from liberalisation of capacity between countries, it may not be that each of the two countries gains. There can be cases where, on balance, a country loses if it liberalises. This said, it needs to be stressed that this is not a typical case- indeed, the circumstances supposed were extreme. This highlights the need to examine cases in detail, and not to make broad generalisations.

Case 3: Opening ***up Gateways***

Here it is necessary to make a distinction between the country gaining a gateway for its airlines and the country granting access to its gateways.

The Country Granting Gateways
Suppose that this is a country will relatively little outbound traffic- most of the traffic on its air routes is inbound. Suppose it has an airline with a moderate share of the traffic. The country has a problem in obtaining foreign exchange and it has an employment problem.

When the gateways are opened, new services to secondary (perhaps tourist) destinations are commenced, primarily by the other country's airlines.

The benefits and costs to the country will be as follows:

- Passengers. Since the home country has few passengers on the new routes, the gains will be small.
- Airlines. The country's airline(s) will not be much affected- they may lose a little from indirect competition.
- Inbound Tourism. There is a major increase, of benefit to the country.
- Outbound Tourism. There may be a slight increase.
- Government Revenue. This will be positive, due to the increased tourism.
- Foreign Exchange. This will be positive due to the increased tourism.
- Employment and Skills Development. These will be positive due to the increase in tourism.
- Risks. Any change is likely to be minimal.
- Business Communications. There may be a slight positive effect.

Overall, this country gains, mainly because of the positive effects on tourism.

The Country Gaining Gateways
It is supposed that this country has a big outbound tourism market, and an established airline industry. It has no foreign exchange or employment problems.

The benefits and costs to the country will be as follows:

- Passengers. This will be a major benefit, due to new tourism destinations opening up and lower fares (more direct services possible).
- Airlines. Airlines from this country will also gain from the opening up of markets.
- Inbound Tourism. There may be a slight gain.
- Outbound Tourism. This will increase significantly, with some negative impact on tourism benefits to the home country.
- Government Revenues. The impact will be indeterminate- more airline activity being offset by less tourism activity.
- Risks. These will not change significantly.
- Business Communication. There may be a slight positive effect.

Overall, this country will gain, mainly because of the gains which its passengers make and the additional profits to its airlines.

8. OVERALL ASSESSMENT

8.1 General Overview of Air Transport under Open Sky

The move to Open Sky will result in a more competitive air transport industry. Individual route markets will become more competitive- this will be especially so for those markets which are restricted at present. There will also be more scope for airlines to access additional markets. Thus existing airlines will be able to expand their networks, and serve routes which make operational and economic sense, but which were not feasible under regulation. In addition, new airlines, including some low cost carriers, will enter. The overall size of the air transport market within ASEAN will increase, and there will be new services operated, including services to new gateways. The greater density of traffic will also lead to greater frequencies on existing routes.

Overall fare levels will decline, though not on all routes. Currently some routes are cross subsidised from profits on other routes, and as these profits are eroded, it becomes infeasible for airlines to maintain cross subsidies. The reduction in fares will be good for passengers, though not for airlines. Where more competition comes about on routes which were restrictively regulated, it will lead to lower fares, and a transfer from the airlines to the passengers. However not all fare reductions are at the expense of the airlines. When airlines offer new services, especially on a low cost basis, passengers and airlines can both gain.

This scenario will lead to an adjustment problem for existing airlines. Where they currently have some profitable routes, these will become less profitable. If they are only just covering costs at present, they will have to make adjustments. Either they will need to reduce costs in total, or they will have to cut back on unprofitable routes. These are likely to be routes which are currently quite competitive, but on which they are less competitive than their rivals. In some cases, with thin routes on which they have a monopoly, there will be scope for them to raise prices. Overall costs will fall, either through existing operators reducing their costs in the face of increased competitive pressure, or as a result of the replacement of one airline by another, better suited to serving a particular route.

8.2 Benefits and Costs to ASEAN as a whole

The main beneficiary of Open Sky in ASEAN will be passengers. They will gain in two ways:

(a) Through improved services; with increased frequency, new services to existing gateways and services to new gateways, better connections and new types of products. It is difficult to measure how large these gains are likely to be. They will not come at a cost to the airlines supplying the services, since the airlines will have greater scope to offer new products.

(b) Through lower fares. These will be, to an extent, at a cost to the airlines, at least in the short term.

When fares are reduced, for example when competition intensifies, airlines will suffer a loss of revenue. To an extent the airlines will be able to improve productivity and lower costs- this will mitigate the loss they face. Costs will also fall as one airline, with lower costs, replaces another on a route. In the short term, the reduction in costs is likely to be less than the reduction in revenue, and airlines will lose out. In the longer term, this need not be so.

If there is no reduction in costs, the gain to the passengers from fare reductions will approximate the loss to airlines, and overall, there will be no gain. When there is a reduction in costs, the net overall gain will approximate the fall in costs.

Open Sky will be positive for ASEAN as a whole to the extent that costs fall and there are more and better services, and if all the passengers who gain are from ASEAN. In fact, this is not the case, and some of the fare reductions are enjoyed by passengers from outside ASEAN. Intra ASEAN tourism flows are small for most member countries, and the countries compete mainly for tourists from outside ASEAN. Most of the impacts on airlines will fall on ASEAN owned airlines however (there is a small proportion of 5^{th} freedom traffic carried by non ASEAN airlines within the region). In this situation, it is at least possible that the ASEAN nations could, on a net basis, lose. This could be the case if there were large fare reductions which came mainly at the expense of airlines profits, but non ASEAN passengers gained a high proportion of these reductions.

This point can be illustrated by way of an example. Suppose that there is a fare reduction on average of 20% of airline revenues. Suppose that there is a cost reduction of only 5%- the airlines would then lose profits equal to 15% of revenues. Suppose further that ASEAN residents make up only half of the passengers within the region- they would enjoy a gain equal to 10% of airline revenues. In this situation, the gain to ASEAN passengers would be less than the reductions faced by ASEAN owned airlines, and overall, ASEAN countries would lose out. This is not a likely situation however, especially in the long run. As long as ASEAN residents make up a high proportion of the passengers, and cost reductions are significant, ASEAN countries as a whole will gain, apart from any other benefits from Open Sky.

Other than the impacts on passengers and airlines, the next largest impact will be on tourism. If non ASEAN residents are a high proportion of passengers on intra ASEAN flights, the fare reductions they enjoy will make ASEAN countries as a whole more competitive as tourism destinations. As a result, more visitors will come to ASEAN countries, and tourism expenditure will increase. ASEAN countries will gain from this. It is not possible to be definitive on the size of this gain, and it depends on the elasticity of tourism flows with respect to ASEAN internal air fares, and to improved air services, and also on the percentage of additional tourism expenditure which represents a net gain for the economies. This percentage will be much less than 100%, because if the tourist spends an additional $1000, there will be the costs of the goods and services which the tourist is supplied with. However, in most circumstances there will be a gain. Thus, the gain to ASEAN from a $50 reduction in an air fare will be greater if an ASEAN resident is the passenger than if a non ASEAN resident is- however, even if the latter is the case, ASEAN countries gain from the additional tourism expenditure stimulated.

There will be a further tourism benefit to ASEAN countries through ASEAN becoming more competitive as a destination for ASEAN residents. Lower fares and better services within ASEAN will mean that some travellers who would have gone out of ASEAN for a trip will switch to a trip to ASEAN. This too will be positive for ASEAN tourism industries, increasing expenditure and providing benefits for ASEAN economies.

The gains to ASEAN countries from Open Sky depend on several parameters. These include:

- The extent to which costs fall and how this compares to falls in fares;
- The proportion of travellers on intra ASEAN flights who are ASEAN residents;
- The extent to which falls in air fares stimulate more tourism to ASEAN countries, and encourage ASEAN residents to switch their trips to within rather than beyond ASEAN; and
- The proportion of additional tourism expenditure which is a gain for the economy.

The possible magnitudes of these parameters are explored in the next section.

In addition to the direct and tourism benefits, Open Sky can impact on other dimensions of benefit and cost for the region as a whole.

8.2.1 Foreign Exchange

As a result of Open Sky, there will be more inbound tourism and les outbound tourism- to this extent, the net impact on foreign exchange earnings will be positive. In addition, to the extent that it is the relatively lower income countries within ASEAN which have foreign exchange problems, since the increased travel within ASEAN will tend to come from higher income countries, the largest share of gains in foreign exchange will accrue to the countries which need it most.

8.2.2 Employment

Airlines which are under pressure will reduce costs and this will lead them to reduce their workforces. However, since air travel has a quite high price elasticity, lower fares will lead to more travel. On balance, the airline industry will expand and on balance employment is likely to increase. In addition, the increased tourism within ASEAN countries will also lead to increased employment.

8.2.3 Government revenue

The decreased profitability of airlines in the short run may lead to a loss of government revenue. However, this effect will be counteracted by an increase in tourism, which will lead to additional receipts to the extent that tourism is taxed. In the long run, the government revenue effects should be positive.

8.2.4 Risks

Open Sky will result in a less controlled development of the airline industry, and to this extent, it may lead to some risks. For example, cities which have services may lose them (though it should be noted that these risks already exist). On the other hand, the growth of the industry, accompanied by a greater diversity of airlines, will tend to reduce risks.

8.2.5 Business Communication

Improved air links, better services and lower fares should lead to the costs of doing business between ASEAN countries being reduced; this will lead to closer integration of the economies and gains from specialisation and economies of scale.

8.3 Estimating the Key Parameters

8.3.1 Impacts on Prices, Costs and Profits

It is not possible to make a forecast on what the percentage fall in costs as a result of liberalisation will be- this depends on how efficient the airlines are at present, what scope there is for productivity improvements, and what scope there is for a better allocation of airlines to routes. It is possible to outline how falls in fares and costs will be related however.

In the short term, it is possible that there will be a period of intense competition, and this could result in falls in air fares greater than cost. This could come about if some routes are currently restrictive and highly profitable. This period of competition would mean lower profitability for airlines in ASEAN as a whole. If the starting point is one of only moderate profitability, there could be a period of loss making, on average. As long as governments are not prepared to subsidise their airlines, this would not be a sustainable situation. Some airlines would contract or exit, competition would become less intense, and fares would subsequently rise.

Over the long term, fare reductions will tend to be of the same order of magnitude as cost reductions. Thus, if costs fall by 25%, fares will tend to fall by the same percentage. If costs fall by more than fares, additional competition will tend to bring down fares. If costs fall by less than fares, airlines will become unprofitable, and some will exit, some higher cost airlines will be replaced by lower cost airlines on routes, and on some routes, competition will be reduced and airlines will be able to raise fares. While there could be an initial period after liberalisation of vary low fares, this will not last, and fares will settle at more sustainable levels. This is the experience of other airline markets which have been liberalised- fares track costs over the longer term.

In the sort term, airline profits could fall. In the long term, while they may become more variable and cyclical, they are not likely to fall, on average. Some airlines will do poorly under Open Sky, but others will prosper.

8.3.2 The Size of Tourism Benefits

One key parameter which determines the size of consumer benefits to ASEAN residents, and the size of tourism benefits, is the proportion of passengers on intra ASEAN flights who are ASEAN residents. It is an empirical matter how large this parameter is. It is, however, difficult to measure it with available tourism and air transport statistics, for most ASEAN countries. Statistics are available for some countries, such as the Philippines (see Appendix II).

Another parameter is the tourism demand elasticity- if air fares on ASEAN routes fall, to what extent does this stimulate more tourism to ASEAN, and encourage ASEAN residents to substitute intra ASEAN trips for trips beyond ASEAN? This also is an empirical issue. Worldwide experience suggests that tourism demand is quite elastic- a 5% reduction in the cost of a trip will stimulate a greater than 5% increase in tourism. This is probably true for ASEAN.

A final parameter concerns the proportion of tourism expenditure which represents a net benefit for the host country. This is a parameter which is not often measured. Clearly, when a tourist spends money in a country, on food, accommodation and travel, there will be costs of providing these goods and services. The costs of provision are likely to be closely related to the prices charged, though there could be some differences, for example due to taxes levied on them and profits earned. Thus the proportion of tourism expenditure which remains as a net gain to the economy is not likely to be high. In addition, however, additional tourism expenditure could stimulate the economy, and lead to the use of unemployed resources (eg of labour). While there is a benefit to an economy from extra tourism expenditure, it could be of the order of 10-20% of the expenditure change. Higher proportions could be possible, but they would need to be justified (eg, in the case of substantial impacts on employment in an economy).

9. PROBLEM AREAS

9.1 Introduction

It is inevitable that there will be some difficulties encountered in the move to Open Sky. There are some problem areas likely to be present, and though they will not prevent Open Sky delivering benefits to ASEAN countries, they can prevent it working as well as it might. Three problems considered here are the lack of a competition policy, the possible presence of subsidies to airlines, and the differing business environments in the member countries. These problems can be addressed, though it may take time to do so, and it is advisable that they be given consideration early on in the process of moving to Open Sky.

9.2 Competition Policy

One difficulty which will be experienced in implementing Open Sky in ASEAN will stem from the lack of a competition policy. This lack will not stop Open Sky from working, though it will make it less effective, and result in smaller gains from it than might be achieved.

In most of the jurisdictions in which Open Skies prevail, there is a strong competition policy which supports it. This is especially true in Europe, where competition policy is a core aspect of intra-European arrangements. Many of the countries which have deregulated their domestic airlines, such as the US and Canada, have competition policies which apply to the airlines. Where the US implements Open Skies agreements with other countries, US competition policy is applicable to all carriers, not just the US carriers. In most of the countries operating liberal air transport policies, general competition policy is applied to air transport - there is no specific competition policy for this sector. Many of the countries which have opened up their skies have developed considerable experience in implementing competition policy.

Competition issues will arise when ASEAN moves to Open Sky. They arise already, but because of the regulations which govern air transport markets at present, they have not been much of a problem. For example, airlines do not feel much of a need to indulge in predatory behaviour towards their competitors if their competitors are not allowed into the market in the first place, and mergers between different countries' airlines do not pose problems if they are prohibited under the terms of the ASAs.

Under Open Sky, several competition issues are likely to arise:

Mergers and Strategic Alliances: One of the core objectives of Open Sky is to promote competition. This would be thwarted if firms avoided competition by merging, or by forming strategic alliances. While mergers can increase efficiency and improve the product mix, they can also lead to less competition on the routes which the partner airlines serve. Mergers will be easier to consummate if ownership restrictions are relaxed, as they will be under Open Sky.

Collusive Behaviour and Price Fixing: Even when they are not in a strategic alliance, airlines might agree to fix prices, keeping them high, instead of competing between themselves. Another form of collusion would be market sharing, whereby two airlines agree to serve different markets, and not compete with one another. Where there are only few competitors, as is likely to be the case on many routes in ASEAN, this would be a concern.

Predatory Behaviour: Under Open Sky, there will be an imbalance between the competitive strengths of the different airlines. Some airlines are well established, experienced, financially secure and profitable, but smaller or new entrant airlines will have much less financial backing, and will not be well known. When the new or small airlines enter markets, the established airlines may price below cost to force them out. They may create price wars.

Alternatively, they may schedule excessive capacity. By doing this, the established airlines may be able to prevent competitors getting a toehold in the market, which will remain dominated by the established airlines.

In other jurisdictions, these problems are handled by competition policy watchdogs. For example, EC countries have merger guidelines, which specify which mergers will be permitted and which not. Competition authorities assess proposed mergers or alliances to determine their impact on competition. If the markets which are affected are already very competitive, they permit the merger or alliance to go ahead. Where competition is weak, they may prohibit the merger or alliance, or allow it to go ahead subject to specific restrictions or undertakings. Competition authorities encounter many difficulties in dealing with alleged predatory behaviour, since it is difficult to prove and police. There have been a few successful cases where predation has been proved, and competition authorities are vigilant. As a result, the powerful airlines are careful lest they be charged with predatory behaviour.

Amongst the ASEAN countries, competition policy is in its infancy. Several countries have announced that they intend to develop a competition policy framework, and some countries are actively developing an approach. It has yet to be seen how, and whether, such competition policies as are implemented will apply to air transport. Ideally, there should be no need to develop a policy specifically for air transport.

In the meantime, however, it would be advisable for the member countries of ASEAN to develop a code of conduct for air transport. Some countries have codes for specific industries in place. Over the period of the first and second stages of the move to Open Sky, a competition code could be developed between the countries. Such a code would specify under what circumstances mergers and alliances would be permitted, and it would set out approaches to dealing with anti competitive practices such as collusion or predatory behaviour. Given that there is no central authority, it would be up to the individual countries to police it. The very activity of getting together to discuss competition issues should be a valuable exercise for the member countries as they grapple with implementing Open Sky.

9.3 State Aid and Competitive Neutrality

Open Sky works best when all competitors are competing on equal terms. If one airline is being subsidised by its government, it can afford to lower fares and gain market share. It may push other airlines out of the market. Sometimes it will be the less efficient airlines with higher costs which succeed at the expense of efficient airlines. In the long term, competition will not work well, and costs will be excessively high.

The objective is to seek, as far as possible, a situation of competitive neutrality, under which all competitors are facing similar conditions. In the US domestic market, airlines are not normally subsidised. However, when there was a crisis, as after September 11, 2001, the US government did subsidise the country's airlines, but it tried to assist them all on a comparable basis. Several countries subsidise routes (for example, rural or developmental routes), but they do not subsidise particular airlines- they make the subsidy available to any airline which serves the route, and choose the airline by competitive bidding. The question, for competitive neutrality, is not necessarily one of whether there *are* subsidies, but rather *how* the subsidies are given. It is possible to give subsidies which do not distort the competitive process.

Subsidies to airlines take various forms:

- Airlines are sometimes given direct subsidies. Where the airline is government owned, it may be allowed to operate at a loss, and the government may never expect to be issued dividends.
- Sometimes governments provide equipment or facilities to airlines at below cost.

- When an airline is restructured after a crisis, loans and equity may be written off.
- Some airlines are granted favoured access to government business which is carried at above market rates.
- Subsidies may be embedded in airport charges, to attract airlines to choose certain airports.
- Bankruptcy provisions may enable loss-making airlines to trade while not paying their full obligations (e.g. Ch 11 provisions in the US).
- Airlines may be granted monopoly privileges with which they can cross-subsidise their operations. An example of this would be where the flag carrier is granted a monopoly of ground handling at the main airport.

This is not an exhaustive list of types of airline subsidies. Airline subsidies around the world are very common and very large. They distort the process of competition. To a substantial degree, they often fund inefficiency and high cost rather than low fares, so their impact on competition is muted. It is often the heavily subsidised airlines which are the poor competitors, rather than the strong ones, and this means that the impact on competition is not so great.

The problem of state aid to airlines is taken very seriously in the EU, which is the most comprehensive example of open skies amongst a group of regional partners. Any state aid to an airline, for example, for restructuring after a crisis, must be approved by the European Commission, which will only grant approval after a detailed investigation. Essentially, the aid has to be one-off, and not recurring. Not all requests are approved. Guidelines for aid by member country governments have been developed. Subsidies can be given to routes, but they must be transparent and not granted to specific airlines. Recently, courts have been rejecting subsidies given by regions to attract low cost carriers to their airports.

Subsidies to airlines need not be without some justification, and they can be used to address real problems. Sometimes subsidies may be given to state owned airlines which are by way of compensation for past decisions which have placed a cost burden on them. For example, an airline may have been forced to buy high cost airliners, not the airliners which it would have chosen for their network. Sometimes restructuring represents a correction of earlier financial structures- airlines may have been loaded with too much debt, and too little equity.

In the ASEAN situation, there may be a case for subsidising airlines which are in the development phase in countries with limited experience in international aviation. It may take some time before an airline is cost competitive, granted that it may have to develop managerial and labour skills in a difficult environment. If Open Sky leads to a competitive environment, it may not be protected by regulations from more cost competitive rivals. Subsidies will enable it to compete and become more cost competitive. If subsidies are granted for this reason, there should be a sunset clause- subsidies should not be granted indefinitely.

There are several ways in which the problems associated with subsidies to airlines can be addressed, though none works perfectly:

- Privatisation of airlines does not eliminate subsidies, since governments can still subsidise private companies. However, it does make any subsidies more transparent, since they are less likely to be hidden in the accounts (which may not be published). Governments are usually less willing to subsidise private companies, and more inclined to expect them to survive on their own.
- Where routes are to be subsidised, this can be on the basis of making the subsidy open to any carrier willing to operate the route, and choosing the recipient on the basis of a transparent bidding process.

- Where there is assistance given to an airline, a sunset clause, specifying when the assistance is due to end, can be specified.
- When aid is given to restructure itself after a financial crisis, this should be on a one-off basis. It should not be the case that an airline can periodically appeal to its government for assistance to cover losses due to poor performance.

ASEAN governments will need to address the airline subsidy issue, and to determine how they would like to handle it. A first step would be to document the subsidies which are being granted by member nations, and to assess how large they are. They may choose, over time, to develop a set of guidelines for member governments to implement.

9.4 Business and Operating Conditions

Within the ASEAN region, there is a wide variety of business and operating conditions facing airlines, and these affect their ability to compete. In other examples of open skies, especially Europe, all airlines face similar business conditions. Laws are similar, wage rates are comparable, business infrastructure in different countries is at a similar stage of development, skills are readily available, and capital markets are well developed. In Europe, partly as a result of an economic integration process which has being going on for decades, business conditions are much more similar amongst countries than they are amongst the ASEAN member countries at present.

In ASEAN, business conditions differ widely from country to country. In some countries, it is straightforward and easy to set up, finance, and run cost competitive airlines. In others, it is proving to be very difficult. Some countries face considerable difficulties in being able to operate airline services, and these difficulties are not likely to be eliminated in the short term. ASEAN economic integration will be a gradual process.

To this end, building up air transport institutions, such as competitive airlines, will be a demanding task. To begin with, ASEAN carriers have different capabilities as demonstrated in the country reports and highlighted in Chapter 6. Take the “superpowers” namely Singapore, Thailand, and Malaysia. Singapore Airlines utilizes the most modern fleet of aircraft (see Appendix 6) while Thai Airways has a large, very mixed and somewhat aging fleet (though it is in a fleet renewal program). Malaysia Airlines on the other hand is undergoing a restructuring program. Most ASEAN carriers are still struggling to recover from the past crises that hit the airline industry – Asian financial contagion, September 11 terrorist attacks in the US, the Iraq War and most recently the SARS outbreak (see Appendix 7). These airlines need capital or investments to run their programs more efficiently.

Ideally, the move to Open Sky will take place in a way which gives scope for the airlines of the member countries to establish themselves as adequate competitors and the ability to survive in markets. Institution building will be a critical factor which conditions how the move to Open Sky is achieved.

One option is for countries not to be significant producers of airline services themselves. If skills and finance are scarce, it may be preferable for them to rely on services provided by airlines of other countries, especially those of their ASEAN partners. A country may choose to contract out its airline services to airlines of other countries which are better established and more cost competitive. Several smaller developing countries (for example, a number of Pacific Island nations)have taken this option around the world. They can still retain a good deal of control over what happens in their air transport markets if they contract out services rather than simply liberalise completely. This may be an option which some ASEAN countries find attractive as Open Sky unfolds. Another option is to relax ownership rules in order to encourage infusion of fresh capital from other ASEAN nationals and from non ASEAN in the longer term. However, the process may require more time for some countries which need Constitutional amendments to implement reforms.

Protection is another path. A country's airlines may be protected from competition from stronger airlines from other countries, and this will assist them to develop. Protection means restricting access and delaying the move to Open Sky. While protection may have a role in the short term, it is not likely to be a desirable option for the long term. If protection is granted without time limits, it will result in the airlines never developing the ability to compete. It will also mean that the country is cutting itself off from the benefits of air transport at a critical phase in its development.

Even where countries choose to protect their airlines, they can do so in ways which promote competition within. Rather than grant monopolies to favoured airlines (which never face the pressure to perform), a country can encourage competition and allow new airlines into its markets. Since all the airlines from the country (or regional grouping of countries, such as the CLMV countries) will be facing the same conditions, and not facing competition from strong airlines of other countries, they will have the scope to develop their competitive skills. For the long term, it is desirable that a country's airlines develop the ability to compete, and this can only happen if they face actual competition.

Market segmentation is another way in which airlines can become established and develop their competitive skills. If new airlines are permitted on to secondary gateways, which are reserved for them, they will be able to become established. There may be a case for protecting the incumbent carriers from new entrants on the main routes- their revenues will not be diluted by competition from underfinanced, opportunistic airlines. However, a policy of market segmentation should be seen as a temporary one, to give new airlines the opportunity to develop, and sunset clauses should be imposed. After a specified time all routes, main and secondary, should be opened up to all airlines.

None of the options suggested above will remove all the difficulties of establishing airlines on a competitive footing across all the ASEAN countries, granted the big variations in business conditions. These variations will remain, and they will affect the competitiveness of airlines from different countries. However, differences in business conditions need not be a prohibitive barrier to being competitive- after all, several ASEAN country airlines have established themselves as very strong competitors on world markets over the past three decades, in spite of facing business conditions at home which were very different from those of their competitors.

10. FACILITATING CHANGE

Individual countries have different approaches to liberalization but there are some which can be harmonized at the regional level in order to manage the transition towards an ASEAN Open Sky and maintain the momentum created by the existing initiatives. There is no easy path but the gains for all nations can be found by considering some facilitation measures at the regional or sub-regional levels. These measures are needed to bridge the gaps in the levels of capabilities of individual economies and airlines and eventually provide for a smooth transition to an ASEAN Open Sky. The facilitation measures being proposed in this study have considered the existing policy frameworks and agreements in the areas of trade, investments as well as existing cooperation efforts in the different aspects of aviation.

10.1 Linking aviation with trade in other goods and services

In order to maximize the gains from trade, countries have the option to negotiate a packaged deal rather than a single good or service such as aviation. When airline services are liberalized, it is possible that the airline industries of some countries will lose. Thus, liberalization will be viewed to have a net negative effect on the economy. However, when the airline industry is grouped with other industries in trade negotiations, the losses in one industry (airline services) may be outweighed by gains in other industries (agriculture or garments manufacturing or IT-enabled services). Linking trade in aviation services with other goods and services is important to form successful free trade blocs. The competitiveness of manufactured goods relies on the ability of transport and other services to support the movement of these goods.

The ASEAN Free Trade Area (AFTA) is a good venue for negotiating free trade in commercial air services. However, the AFTA covers quite a number of sectors in its exclusion list and air transport is one of them. In the past 10 years, we have witnessed significant reductions in the tariffs on manufactured goods but very slow progress in the opening up of the services sector, the backbone of a competitive manufacturing sector. It is not surprising that the ASEAN 6 did not include aviation. Even the European Union did not at first include aviation in the Treaty of Rome. However, it was the European Court of Justice that forced the inclusion of aviation in the overall package of trade liberalization. Such a supranational body does not exist in ASEAN given the consensus-based approach of the members. Hence it might be difficult to link aviation services with AFTA provisions on a regional level.

There has not been much progress in services liberalization under the ASEAN Framework Agreement in Services (AFAS). And given the slow progress in the General Agreement on Trade in Services (GATS), it is less likely that the AFAS will also have significant impact on the services sector of ASEAN.

At present, aviation is included as part of the entire package of economic cooperation in BIMP-EAGA and IMT-GT. However, there is a need to expand that economic cooperation on the national and sub-regional levels. Under the three sub-regions proposed in the study, the member countries will agree to include air transport services liberalization as part of an overall economic package. Furthermore, the scope of liberalization can go beyond the provisions under the GATS and AFAS (i.e. selling and marketing services, computer reservations system and aircraft maintenance and repair) and include the other policy options presented in Chapter 6.

Should the linking of aviation with trade in other goods and services materialize, institutional changes will likely take place. Under such arrangements, transport officials may not necessarily take the lead in the negotiation process since the package will cover more than air transport. However, it is important that stakeholders in the air transport sector are consulted prior to the negotiation process and that transparency is achieved in the consultation process.

10.2 Building strategic links between aviation and tourism and other users

It has been observed during the fieldwork that users of air services, particularly tourism and trade-related agencies are not generally part of the negotiating panels therefore limiting negotiation perspectives to pure traffic rights issues – that is, gaining the same amount of access given to the other party. Most tourism authorities are hardly aware of the developments in air transport services under the ASEAN Air Transport Working Group. If ever they are aware of these issues, the implications to tourism are hardly discussed by the tourism authorities within their organization and with the other stakeholders.

As mentioned in the beginning of the report, the move toward ASEAN Open Sky is not a recent initiative but an integral part of ASEAN Economic Community vision. A closer integration can be achieved through joint working group meetings for air transport and tourism. This is one way of supporting the ASEAN Leaders' directive to accelerate the integration of the air travel and tourism sectors (9th ASEAN Summit, Myanmar, October 2003). This will also facilitate the development of a regional action plan for staged and progressive implementation of Open Sky. Furthermore, the benefits experienced by tourism as liberalization progresses can give the tourism industry a stronger representation in the aviation policy framework, demonstrate the benefits from an Open Sky environment and therefore allow policy makers to make a balanced evaluation of the available policy options.

10.3 Promoting Transparency

A policy option presented in Chapter 6 is the movement from single designation to dual and eventually to multiple designation policy. Together with relaxation of route controls and adequate infrastructure, this policy can enhance the benefits from liberalization.

The shift however calls for greater transparency in the allocation of traffic rights and even landing slots between or among carriers. Countries such as Malaysia, Indonesia, Thailand and Philippines have government and private carriers which compete for the limited traffic rights under either a dual or multiple designation policy. Given the lack of competition policies in the aviation sector, it is common to observe the government-owned or controlled airline or the older carrier to receive majority of new traffic rights negotiated for the country. In most cases, these established airlines argue that they deserve to be granted with those traffic rights given their huge investments in developing the routes in the past. Consequently, secondary or smaller carriers are prevented from exploiting commercial opportunities in those markets. Allocation of traffic rights is usually based on a first-come first served basis and there are cases when the process of allocation is not made transparent.

10.4 Building Capabilities

In managing the transition, capability-building measures are needed in order to broaden the perspective of negotiators and air transport officials on aviation issues, particularly in preparing negotiating positions. They include training, workshops, development of appropriate policy regulation framework and setting up of institutional organizations or making existing organizations more efficient through separation of functions like ownership, regulation and operations. Such measures will allow appropriate staff to be capable in managing the liberalization environment.

The current focus of training and cooperation among aviation authorities is on the technical, safety and security aspects of aviation. However, there is a need to introduce or increase rigor of discussion of aviation issues. Training on the economics of aviation issues, for example, is not a core agenda when it is greatly needed to strengthen the capacity of the civil aviation authorities and to make policy makers more aware of the benefits and costs to expect from Open Sky. These activities can be funded by ASEAN and/or other external agencies at the sub-regional levels or at the regional level.

A major problem area in ASEAN is the unevenness of the airlines' capabilities. Relaxing ownership rules can partly address the problem. But efforts can be enhanced by greater cooperation in assisting less capable airlines on technical and management aspects. Countries can likewise manage transition by limiting the entry of stronger carriers in the major gateways for a certain period of time.

10.5 Exploring demonstration effects

ASEAN has witnessed the entry and growth of low cost carriers such as Cebu Pacific and Air Asia particularly in the domestic market. These carriers have expanded the choices available to consumers through lower fares and more access. Some have started to operate in secondary gateways, developed the tourism markets and facilitated the movement of the travelling public in general.

By exploring the demonstration effects from the impact created by low cost carriers the industry will illustrate the possible gains from more competition. And as consumers experience these gains, they will likely pressure older or bigger airlines to become more productive and cost-competitive.

The demonstration effects need to be documented and disseminated to the public through media, seminars and workshops in order to build a broader base for consumer interests in the field of aviation policy-making.

10.6 Promoting Coordination and harmonization

It has been observed that aviation authorities and associations monitor and maintain different databases (see Appendix 8). It can be easy to get statistics from some countries and difficult in others. Thus, it becomes time consuming and costly to secure and harmonize data at the regional level.

As ASEAN moves toward Open Sky, it is important to develop or build a better database on aviation. This will allow airlines to identify niche markets or opportunities as dynamic changes are experienced. Policy-makers will also become more capable of evaluating the impact of policy options.

This kind of facilitation measure has been done by ASEAN for investments. Under the ASEAN Investment Area (AIA), ASEAN worked to harmonize the Foreign Direct Investment data collection and reporting system in compliance with the set of deliverables agreed by the AIA Council. A comprehensive and comparable set of statistics on FDI in ASEAN has been compiled and published already. However, this output was achieved after a number of capacity building activities like seminars or workshops to promote a better understanding of why such statistics should be collected and harmonized. This can likewise be done in aviation so that users can substantiate their gains and for airlines to exploit opportunities behind the statistics.

One of the important task or issue for ASEAN's move towards Open Sky is the question of how to manage the 3 sub-regional initiatives being proposed in this study. A major priority of those responsible in the process is to create and sustain the synergy among these groupings.

11. FURTHER RESEARCH AND ADVICE AND ASSISTANCE

11.1 Introduction

In this chapter the consultants outline areas of further research and also propose technical assistance of both an advisory and implementation nature. There is also a perceived need to make available to the airline and tourism industries the research results. The proposed dissemination of the research is to gain broad support for the policy agenda it proposes and alleviate concerns, particularly from the scheduled airline industry, about the impacts of the new regional groupings and changes to the policy agenda.

The first of the research proposals is for a major piece of work on two aspects of the external impacts of a liberalised open sky environment within ASEAN. The second section will deal with a proposal for three smaller but crucially important policy issues that ASEAN member economies need to address: competition policy, state-aid for airlines and consumer rights. In section 11.4, technical assistance projects are identified: assistance to the ATWG sub-group on this report and the facilitation of sub-regional and policy changes. Section 11.5 deals with dissemination of the work to interest groups as well as the provision of educational and training programs. Section 11.6 identifies a coordination and harmonization effort in the area of database collection.

11.2 ASEAN and External Relations for Itself and Its Carriers

Even when ASEAN member states are able to bring about a complete ‘Open Sky’ within ASEAN (and in this report we have proposed a long time scale), ASEAN states have to deal with the external relationships. As has been demonstrated in the report, there are extensive operations by non-ASEAN airlines within ASEAN and there are, as a direct result of the bi-lateral system of air service agreements, a complex web of external agreements. As an example, Thailand has ninety four (94) air service agreements of which it has only nine (9) within ASEAN. Some of these external or non-ASEAN agreements are of great importance, such as USA, UK, Australia, China, Hong Kong and Japan, whilst others, such as those with some African states are of lesser importance.

The external issues are further complicated by the involvement of two ASEAN economies (Singapore and Brunei) in the so-called “APEC Open Skies” agreement. It is not seen as likely that other ASEAN states would wish to join this agreement and thus there is a complication of a possible future ASEAN agreement with the United States of America, with two economies participating in a presumably different, multi-lateral agreement involving the United States.

As part of building up the external understanding of ASEAN air transport policy, the following work is proposed.

- Detailed study and report upon the European Union approach to external relationships, including the way it addresses (in particular) ownership and control issues and 5th freedom rights. The very important negotiations between the E.U. and the USA will establish a framework upon which a future aviation regulatory platform for all regional groupings of states can be built. The progress and finality of this will be reported upon and the implications for ASEAN and its member drawn out.

- A detailed mapping of the external aviation relationships of the 10 ASEAN states. This will involve the states in disclosing information which aviation negotiators regard as being confidential, however if ASEAN is to be an effective regional grouping in the aviation sector, then such disclosure is essential. (Consultants can be sworn to a confidentiality agreement and specifically protected data disguised and not distributed).

- Mapping of use of rights by ASEAN carriers – both from ASEAN points to points outside (3rd and 4th freedom rights, and 5th freedom rights) and completely outside of ASEAN.

- Mapping of rights used by the bi-lateral partners, both from points outside ASEAN and within ASEAN. The "mapping" of rights utilized will identify flights, routes, aircraft types, frequencies and seat numbers.

- Assessment of ASEAN's aero-political situation vis-à-vis major markets.
  - Europe
  - China/Japan/Korea/India
  - South Asia and Middle East
  - Oceania
  - Lesser markets

- Development of a strategy for ASEAN as a region to deal with external aviation partners, both individual countries and regions.

- Development of strategies for individual countries, so as to ensure they fit within overall ASEAN strategic framework and still optimise opportunities to develop the route network of their own carriers and/or their own inbound tourism industry.

11.2.1 Performing The Task

This task would be performed by a mixture of desk and field work. The desk work would be predominant. It will be essential to visit most ASEAN members (but not necessarily all, unless ASEAN Secretariat feels it is important). Visits would be very focused and could be shortened to 1 day for smaller countries and 2 days for larger aviation countries. A visit to E.U. – (Transport Directorate) will be required, and also APEC Secretariat (in relation to APEC Open Skies Agreement). The task should be commenced after the next ASEAN Air Transport Working Group.

11.3 Policy Studies

There are two policy studies which ASEAN should undertake, both of which will result in ASEAN wide implementable guidelines for enhancement of competition with its attendant benefits.

11.3.1 Competition/Consumer Policy

A code of conduct in relation to competition and consumer policy should be developed. This code of conduct could be in 4 streams:

1. Airline code of conduct stream which will address issues such as predatory behaviour (pricing and other aspects, including capacity dumping) and consumer rights (denied boarding etc).
2. Airport's code of conduct which will include issues such as access and pricing policies. This is important as airports resemble a natural monopoly and can exercise market power in a way that is detrimental to airlines and consumers.
3. CRS/GDS code of conduct. Many countries have adopted a code of conduct form of regulation for CRS/GDS behaviour. There are now new but related issues in relation to protection of consumers in relation to internet selling by travel agencies and airlines.

4. Consumer issues such as denied boarding compensation.

As ASEAN is a co-operative regional body, it does not have legislative powers but it possesses important powers of persuasion: a code of conduct approach to competition policy is consistent with such persuasive powers.

Subsidies and State Aid

Principles for Implementation. This study is seen as critically important: the European Union has, this month (October 2003), again enunciated its concerns about unfair subsidies and is proposing legislation which will impose penalties upon airlines (both from within and outside of the European Union) which it judges to be the beneficiary of subsidy or state aid which results in unfair competitive advantage.

Again, ASEAN can only use its persuasive powers, however the development of guidelines and principles which member states could adopt (and hopefully adopt across ASEAN) is seen as enhancing competition with ASEAN and may help those carriers which operate to Europe to avoid difficulties with the E.U.

11.3.2 Mode of Study

These 2 studies are seen as best being packaged into one project and undertaken as "desk" tasks, i.e. without fieldwork (but having access to a focal point in each country who could respond to enquiries and provide information).

At the draft final report stage, there should be a presentation to the ASEAN Air Transport Working Group, at say, the 2nd meeting of 2004. This study could be conducted in 2004, after the first (which is the 9th) ASEAN ATWG Meeting.

11.4 Facilitation of Sub-Regional Agreements and Policy Changes

It is proposed that a facilitator could play an extremely useful role in assisting the parties to join together in the sub-regional agreements. The introduction of Thailand and Brunei into CLMV will be complex, particularly if some liberal policy changes such as a principal place of business test are combined with geographical issues and the staged entry of Thailand (2^{nd} level airports first).

Two meetings will be necessary (but budget provision could be made for three meetings). Some preparation will be required, as will a small meeting room. Each country should meet its own costs. For each negotiation, six days, inclusive of travelling time should be allowed and the negotiations should take place in CLMV + T territory.

11.4.1 Assistance to ATWG Sub Group

It is recommended that the team (or part thereof) work through the report with the sub-group of the ASEAN ATWG in order to be able to best address the important policy and other changes which the members of ASEAN should undertake on the path to "Open Sky".

11.5 Training, Education Activities and Publicity

There are 3 discrete activities which are proposed. They would be conducted as separate activities but the first two could be conducted consecutively. The third activity is hard to programme at this point and may be undertaken at a variety of places and times.

11.5.1 Training Workshop

During the field work and to some extent at the ATWG meeting in Manila, it was observed that the knowledge of air transport regulation and the way airlines react to the regulatory environment was both highly formalised and with learning based on documentation.. There is scope for the conduct of training workshop for country aviation and tourism officials, airline officers and ASEC staff in the economic impacts of air service regulation. Attention would also be given to the ways airlines respond to regulation, including issues such as code-shares, alliances, pricing and distribution.

The ideal timing would be immediately before or after an ATWG meeting at the same or nearby location.

11.5.2 An Integrative Forum

This might be conducted by ASEAN in conjunction with a body such as Pacific Economic Co-operation Council (PECC) which embraces Industry/Government and Academe. It could also be run as a related activity to the communications and/or financial services regional studies which are part of the REPSF agenda. A 2 – 3 day forum is envisaged (embracing 2 or 3 of the REPSF agendas). Invitations could be widely issued and this activity would be oriented towards senior policy officials, academics and private sector officials from both the operating and investment communities. It is suggested that it needs 6 months planning of the programme and marketing of the event.

11.5.3 Publicising the Initiative

There is considerable scope to bring the industry (including the wider tourism industry) onboard to the liberalism agenda by two methods:

1. Media placement – travel trade press, specialised aviation press and the general Asian but particularly the “quality” papers (SMCP, ST, FT, IHT, AWSJ and FEAR). This could be handled by ASEAN Secretariat Press Office, with the consultants providing input and checking of proposed releases.
2. Conference speaking engagements could potentially be arranged via Pacific Asia Travel Association (PATA), ASEAN Tourism Forum, The Mekong Tourism Forum, the Association of Asia Pacific Airlines and other industry events. This activity needs to be planned sometime ahead in order to achieve relevant speaking opportunities.

11.6 Promoting Coordination and Harmonization

In order to document gains from consumers, give inputs to airlines and investors on market opportunities, and assist policy-makers in becoming more capable in balancing impacts of policy options, we propose the establishment and maintenance of a comprehensive database on ASEAN aviation. The database can highlight ASEAN’s position as an air transport market relative to the major regional groups of with the rest of the world. It can also incorporate tourism and air cargo statistics.

It has been observed that members submit data on city-pair statistics, for example, during the ATWG Meetings. However, there is a need to compile, harmonize, regularly update and disseminate them. In most cases, the member countries are already submitting raw data to the ICAO but they are hardly harmonized for ASEAN’s interests.

The ASEAN Secretariat Infrastructure Unit can possibly take a lead by designating a Working Group on Air Transport Statistics in ASEAN that will be tasked to collect, harmonize and present the data in a way that will be most relevant to the ASEAN members for investments promotion, developing gateways or markets, and promoting competition among others. It can be composed of Air Transport Statisticians from the member countries. The initial meeting can be held during the 9th ATWG in 2004 and a proposed list of capacity-building activities be presented for consideration by the ASEAN Secretariat and the REPSF.

However, external agencies such as UNCTAD, ICAO and even member countries can be tapped to provide technical support and advice and to fund and organize seminars on the value of monitoring and collecting aviation data in a way consistent with international standards while at the same time presented in the most relevant way possible to ASEAN.

Furthermore, ASEAN can produce air transport publications that will cover (but not limited to) topics like: Air Transport Statistics in ASEAN, Compendium of Air Transport Policies in ASEAN and ASEAN Air Transport Investment Map. Attention can also be given to tourism statistics, to ensure that they are collected on a comparable basis across the ASEAN countries (see Appendix 8). An important role of tourism statistics will be to determine the nationality of the users of air transport in ASEAN.

APPENDICES

Appendix 1 - References

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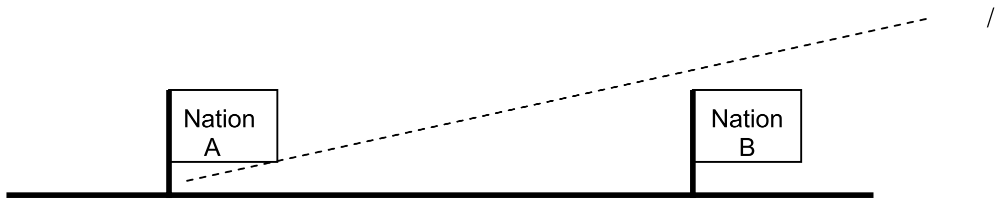
Appendix 2 - A Diagrammatic Explanation Of Traffic Rights

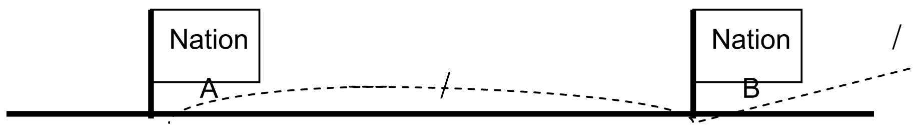
Transit Rights

First Freedom



The privilege to fly over a treaty partner's territory (B) without landing

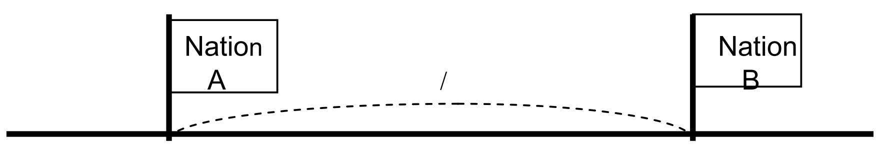
Second Freedom



The privilege to make a technical landing in a treaty partner's territory (B) without picking up or letting off revenue traffic.

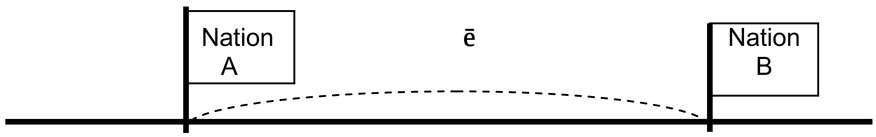
Transport Rights

Third Freedom



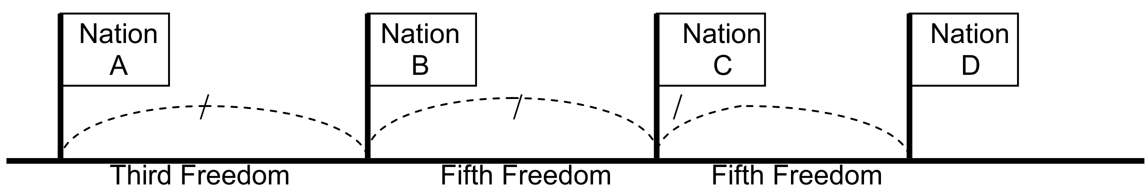
The privilege to carry revenue traffic from the carrier's national territory (A) to a treaty partner's territory (B).

Fourth Freedom



The privilege to carry revenue traffic from a treaty partners territory to the carriers own territory.

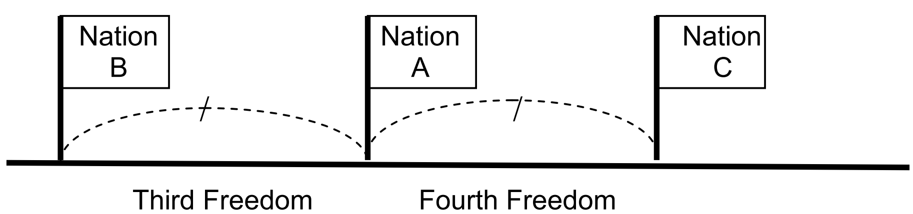
Fifth Freedom



The privilege to carry revenue traffic between two or more treaty partner nations (B to C and/or D) on flights operating out of or into a carrier's national territory (A).

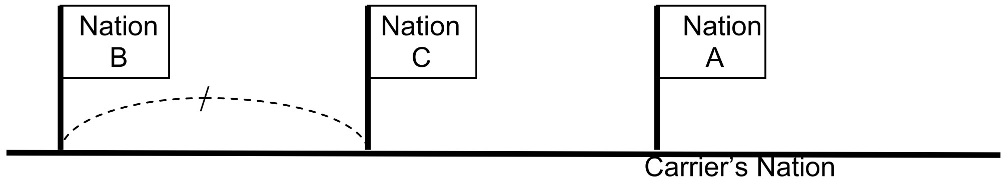
In addition to these five freedoms, the expression sixth freedom is used for the carriage of traffic between two states via the home country of an air carrier. This carriage is a combination of third and fourth freedom traffic. The sixth and seventh freedoms do not have official recognition.

***Sixth Freedom* (Combination of Third and Fourth Freedoms)**



The privilege to carry revenue traffic flown between two treaty partners (B to C) operating through a carrier's territory (A).

Seventh Freedom

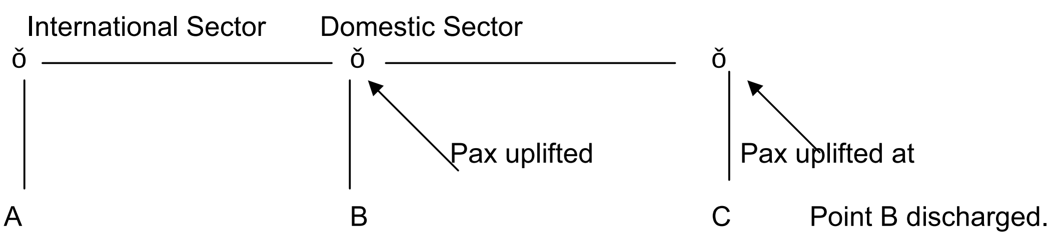


The privilege to carry revenue traffic flown between the territories of two nations (B to C) by a carrier operating entirely outside its own territory (A).

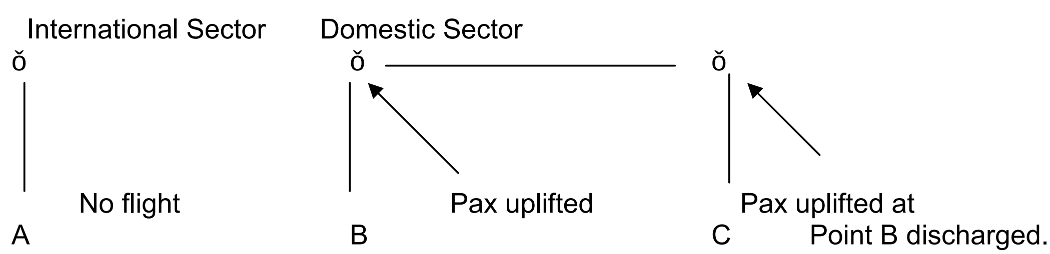
Cabotage

Continuous cabotage occurs when a foreign carrier flies between two domestic points in a foreign country and carries domestic passengers between the two points as an extension of a route originating in its home country whilst discrete cabotage occurs when there is no connection between the two points and a flight originating in the home country. The grant of 100% foreign ownership of domestic airlines might be seen to be investment cabotage.

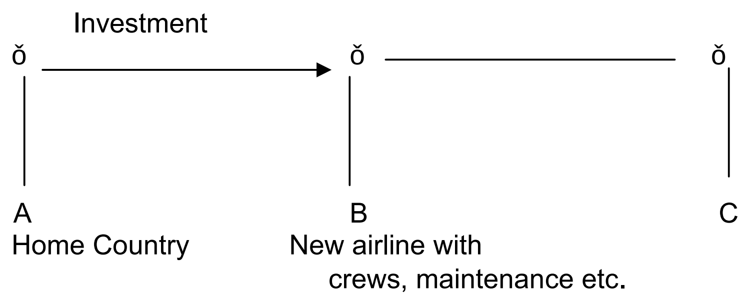
Continuous Cabotage



Discrete Cabotage



Investment Cabotage



Appendix 3 - Terms Of Reference

AADCP Regional Economic Policy Support Facility
TERMS OF REFERENCE
Research Project 02/008

I. Title

Preparing ASEAN for Open Sky

II. Background and Significance

In line with the goal of achieving greater economic integration, ASEAN Leaders during the Fifth Summit (Bangkok, December 1995) decided to include the development of an Open Sky Policy as an area of cooperation in the Plan of Action for Transport and Communications (1994-1996). Thus, the following year, the ASEAN Transport Ministers (ATM) in their first meeting (Bali, March 1996) agreed to pursue cooperation in the "*Development of a Competitive Air Services Policy which may be a gradual step towards an Open Sky Policy in ASEAN*." Such objective has been reaffirmed in the ASEAN Vision 2020 and the Hanoi Plan of Action adopted by the ASEAN Leaders.

The Successor Plan of Action in Transport covering the period 1999-2004 identifies enhanced regulatory and competition policy for the ASEAN civil aviation sector as one of its strategic thrusts. Consistent with earlier declarations, the Plan aims to promote a more competitive environment for air transport services and operations, by way of liberalization initiatives and agreements that may be a gradual step towards an Open Sky Policy in ASEAN. Specifically, it calls for the following: (a) Development of the liberalization policy for air freight services; and (b) Adoption of more liberal and flexible air services arrangements, initially for ASEAN sub-regional groupings like BIMP-EAGA, the CLMV Countries, etc.

The ASEAN Transport Ministers at the 7th ATM (2001) agreed to launch a regional initiative for the progressive and phased liberalization of air services in ASEAN, by providing greater market access, flexibility and capability in air services operations.

The ASEAN Memorandum of Understanding on Air Freight Services signed in September 2002 is a first step towards the full liberalization of air freight services in ASEAN. The ASEAN Leaders are due to sign an ASEAN Tourism Agreement later this year, which among others provide for the facilitation of international travel and intra-ASEAN travel. The ultimate goal of Open Sky would entail a phased and progressive approach to liberalizing (1) Air Freight Services; (2) Non-scheduled Passenger Services; and (3) Scheduled Passenger Services, initially within the ASEAN Growth Areas and between Growth Areas.

Despite the various ASEAN initiatives introduced since 1996, progress towards regional air services liberalization has been less than satisfactory. Moreover, the ASEAN air transport sector is a poorly understood sector. Member Countries are reluctant to open up their air transport sectors as they are uncertain about the potential gains and adjustment costs (or risks) of moving towards a more liberal air transport policy. The restrictive air transport policy regime is blamed for creating inefficiencies in the regional transport chain, hampering ASEAN trade and investment competitiveness and the movement of passengers and tourism development in ASEAN.

Technical assistance is needed to guide the progressive liberalization of air services in ASEAN and to help Member Countries, individually and collectively, prepare for Open Sky.

III. Research Objectives

To assist ASEAN prepare for Open Sky, the study must:

A. Promote understanding of the concept of a highly liberalized and competitive air transport services sector in ASEAN, its challenges, opportunities and options . Specifically, this will require:

1. A critical examination of the key issues and policies in air transport regulation of Member Countries, including the attendant external and internal challenges.
2. A critical review of the literature on Open Sky regimes, discussing the potential and actual gains achieved as well as risks encountered.
3. A thorough evaluation of the benefits, drawbacks and risks involved with the adoption of an Open Sky Policy for individual Member Countries and for ASEAN as a region.

B. Guide the further liberalization of Air Services in ASEAN. Specifically, this will require:

1. A comprehensive assessment of the current status of air services liberalization in ten ASEAN countries and the identification of impediments to further advance liberalization, providing policy options and reforms to eliminate such impediments.
2. A comprehensive assessment of air services regulation in and between ASEAN countries and of obligations already made or likely to be made as a result of member country involvement in groupings such as WTO, APEC etc.
3. The design of a rational, step by step framework to achieving a highly liberalized and competitive air transport services sector in ASEAN, identifying both short-term and long-term strategic objectives, actions, policy options and indicative implementation schedule, with due recognition to fair competition, security, safety and consumer issues and other national policies and priorities.
4. An exhaustive list of additional policy support and regulatory measures as well as technical assistance that may be required to mitigate the potential adverse impact of increased liberalization of air services. Second generation regulatory issues that must be addressed following increased market access must also be discussed, i.e. those issues pertaining to competition and liberalization of trade in aviation-related services in WTO/GATS and in the ASEAN Framework Agreement on Services (AFAS).

IV. Scope of Study

Discussions must not be limited to traffic rights but cover other issues included in air talks such as ancillary services (i.e., computer reservation system, aircraft maintenance and repair). Additionally, in designing the liberalization framework towards Open Sky in ASEAN, the study must not only look at the existing air services agreements of Member Countries but also survey other working models such as those of the European Union, Australia-New Zealand (trans-Tasman arrangement), or other bilateral (e.g. US open skies arrangements with some ASEAN countries and other countries) as well as multilateral agreements developed in WTO, APEC, South America and African countries.

V. Outputs

The consultants will be expected to produce the following outputs by the end of the project:

1. An abstract and an executive summary

2. A full report (no page limit) –
   While reflecting high quality analytical standards, the report should be in a plain style which avoids the excessive use of technical language and jargon. This criterion does not preclude the necessity for providing adequate and appropriate technical details, explanations and methodologies in connection with the project report; such technical detail as may be required should be contained in separate technical annexes to main reports.

The full report must contain a section or chapter thoroughly discussing the policy implications and recommendations.

VI. Documentation and Views to be Considered

Critical inputs to the study include but are not limited to the following documents:

1. ASEAN Vision 2020 (1997) and Hanoi Plan of Action (1998)
2. ASEAN Transport Cooperation Framework Plan (1999)
3. Related Documents and Reports of the ASEAN Air Transport Working Group Meetings
4. Roadmap for Integration of ASEAN: Competitive Air Services Policy (2002)
5. ASEAN Memorandum of Understanding on Air Freight Services (2002)
6. ASEAN Tourism Agreement

Consultant must confer with the Assistant Director and the Senior Officer of the Infrastructure Unit, Bureau of Economic Cooperation (BEC)

VII. Tasks and Required Activities

1. Prepare and present an Inception Report to the ASEAN Secretariat including an outline of the proposed approach to the study.
2. Conduct the study including production of the Interim Report.
3. Present the outcome of the study and a Draft Final Report to the ASEAN Secretariat.
4. Produce the Final Report based on comments and recommendations from participants and reviewers.

VIII. Timeframe and Milestones

The Consultants are expected to complete the study in 5 months. Payment milestones are as follows:

Submission of inception report – 20 %

Interim Report (including report on fieldwork in all ASEAN member countries) – 20 %

Submission and presentation of Draft Final Report to ASEAN Secretariat – 20 %

Submission of Final Report and other outputs listed in Section V of this TOR – 40 %

IX. Expected Modalities and Resources

Team experts specializing in air transport policy and regulation
It is envisaged that the team will be composed of experts from both Australia and ASEAN Member Countries
Required fieldwork: Approximately 3 days to each ASEAN Member Country
Other required travel:

- 3 days to the ASEAN Secretariat, Jakarta to present inception report, conduct interviews, and collect data and/or other relevant documents
- 2 days to the ASEAN Secretariat, Jakarta to present the outcome of the study

Four hard copies (one unbound) of all Milestone reports plus one electronic version must be submitted to the Facility. The successful bidder will be provided with REPSF Report Guidelines that must be used during the production of all project reports

Appendix 4 - Interview Program

In order to facilitate the preparation of information needed for the study as well as the scope of discussion for the interviews, the Consultants sent by email a copy of the questionnaire and list of institutions to be interviewed to the Infrastructure Unit of the ASEAN Secretariat (ASEC). The ASEC then communicated with the focal persons in each member country.

Institutions visited during the fieldwork

A. Brunei
- Ministry of Communications
- Department of Civil Aviation
- Tourism Authority
- Royal Brunei Airlines

B. Cambodia
- Department of Civil Aviation
- Phnom Penh International Airport
- Royal Air Cambodge (non-operational)
- Advisor to Minister for Civil Aviation
- Department of Tourism
- Department of Finance & Planning
- Department of Transport & Public Works
- Airport Constructions

C. Indonesia
- Directorate General Of Air Communications
- Directorate of Air Transport
- Garuda Indonesia
- Indonesian National Air Carriers Association
- Ministry of Culture and Tourism
- Merpati
- Bouraq Airlines
- Mandala Airlines
- Air Paradise
- Private tour operators
- Indonesian Express Delivery Companies' Association

D. Laos
- Civil Aviation
- Lao Airlines – Vice President Economics
- Lao Aviation (Charter)
- Lao Airport Authority
- Vientiane International Airport
- Lao Tourism Authority
- State Planning Committee – Director (Macro Economic Planning, No 2 Structure)

E. Malaysia
- Ministry of Transport
- Malaysia Airports Holdings Berhad
- Malaysia Airlines
- Air Asia

- Malaysia Tourism Promotion Board
- Ministry of Culture, Arts and Tourism Malaysia
- Association of Asia Pacific Airlines

F. Myanmar
- Department of Civil Aviation
- Department of Transport – Director General
- Department of Tourism & Hotels – Deputy Director General
- Myanmar Airlines – CEO and Deputy
- Myanmar International Airlines – CEO and Deputy
- Australian Embassy
- Private sector tour operators

G. Philippines
- Civil Aeronautics Board
- NAIA Authorities
- Air Transportation Office
- National Economic Development Authority
- Subic Bay Metropolitan Authority
- Mactan-Cebu Airport Authority
- Federal Express
- Philippine Airlines – President
- Cebu Pacific – Vice President for Corporate Planning
- Air Philippines – Vice President
- Private tour operators

H. Singapore
- Civil Aviation Authority of Singapore
- Singapore Airlines
- Silk Air
- Singapore Tourism Board
- National Association of Travel Agents Singapore
- Prof M Li, Nanyang Technological University

I. Thailand
- Department of Civil Aviation
- Ministry of Transport
- Tourism Authority of Thailand
- Thai Airways International Ltd
- National Economic & Social Development Board – Office of Prime Minister
- International Civil Aviation Organisation
- Pacific Asia Travel Association

J. Vietnam
- Civil Aviation Administration of Vietnam
- Vietnam Airlines
- Vietnam National Administration of Tourism
- Institute of Tourism Research and Development

Appendix 5 - Template Liberal Regional Air Services Agreement

Template Liberal Regional Air Services Agreement *
[working document for negotiations]

Contents

* Based on ICAO Template Agreement for bi-lateral and multi-lateral arrangements.

Preamble

The Government of ..…. and the Government of …... hereinafter referred to as the "Parties"; Being parties to the Convention on International Civil Aviation, opened for signature at Chicago on 7 December 1944; Desiring to contribute to the progress of regional and international civil aviation; Desiring to conclude an agreement for the purpose of establishing and operating air services between and beyond their respective territories; Have agreed as follows:

The Government of .... and the Government of.... (hereinafter, "the Parties");

Being Parties to the Convention on International Civil Aviation, opened for signature at Chicago on 7 December, 1944;

Desiring to promote an international aviation system based on competition among airlines in the marketplace with minimum government interference and regulation;

Desiring to facilitate the expansion of international air services opportunities;

Recognising the efficient and competitive international air services enhance trade, the welfare of consumers, and economic growth;

Desiring to make it possible for airlines to offer the travelling and shipping public a variety of service options at the lowest prices that are not discriminatory and do not represent abuse of a dominant position, and wishing to encourage individual airlines to develop and implement innovative and competitive prices; and The initial part of the agreement presents the reason for entering into the agreement and declares that they have agreed to what will follow in subsequent parts of the agreement. This approach is common in more liberal agreements and the bracketed text is common to "open skies" agreements.

Desiring to ensure the highest degree of safety and security in international air services and reaffirming their grave concern about acts or threats against the security of aircraft, which jeopardise the safety of persons or property, adversely affect the operation of air services, and undermine public confidence in the safety of civil aviation.

Have agreed as follows:

Article 1
Definitions

For the purposes of this Agreement, unless otherwise stated, the term:

a) "air transportation" means the public carriage by aircraft of passengers, baggage, cargo and mail, separately or in combination, for remuneration or hire;

b) "aeronautical authorities " means, in the case of _ the _; in the case of _ the _ ; or in both cases any other authority or person empowered to perform the functions now exercised by the said authorities;

c) "Agreement" means this Agreement, its Annexures, and any amendments thereto;

d) "capacity" is the amount(s) of services provided under the agreement, usually measured in the number of flights (frequencies) or seats or tons of cargo offered in a market (city pair, or country-to-country) or on a route during a specific period, such as daily, weekly, seasonally or annually;

e) "Convention" means the Convention on International Civil Aviation opened for signature at Chicago on the seventh day of December, 1944, and includes any Annex adopted under Article 90 of that Convention, and any amendment of the Annexes or Convention under Articles 90 and 94, insofar as such Annexes and amendments have become effective for both Parties;

f) "designated airline" means an airline which has been designated and authorised in accordance with Article 3 of this Agreement;

g) "domestic air transportation" is air transportation in which passengers, baggage, cargo and mail which are taken on board in a States territory are destined to another point in that same State's territory;

h) "ICAO" means the International Civil Aviation Organisation; While the Parties to an air services agreement may choose to define any number of terms used in their agreement, for the purposes of clarity or in the event of any possible ambiguity, the foregoing are the terms most commonly found in a Definitions article. For "aeronautical authorities" the required insertions will depend on the prevailing administrative structures and arrangements in place in each Party.

i) "intermodal air transportation" means the public carriage by aircraft and by one or more surface modes of transport of passengers, baggage, cargo and mail, separately or in combination, for remuneration or hire;

j) "international air transportation" is air transportation in which the passengers, baggage, cargo and mail which are taken on board in the territory of one State are destined to another State;

k) "Party" is a State which has formally agreed to be bound by this agreement;

l) ["price"] or ["tariff"] means any fare, rate or charge for the carriage of passengers, baggage and/or cargo (excluding mail) in air transportation (including any other mode of transportation in connection therewith) charged by airlines, including their agents, and the conditions governing the availability of such fare, rate or charge;

m) “territory” in relation to a State [means the land areas and territorial waters adjacent thereto and the airspace above them under the sovereignty of that State] [has the meaning assigned to it in Article 2 of the Convention;

n) “user charges” means a charge made to airlines by the competent authorities, or permitted by them to be made, for the provision of airport property or facilities or of air navigation facilities, or aviation security facilities or services, including related services and facilities, for aircraft, their crews, passengers and cargo; and

o) “air service”, “international air service”, “airline”, and “stop for non-traffic purposes”, have the meanings assigned to them in Article 96 of the Convention. Although the broader and more modern term “price” is used rather than “tariff;” the definition is essentially the same for both terms. For the term “territory” there are two possible ways to define it, one by reference to the definition of that word in Article 2 of the Convention, and the other spelling out the usual meaning attributed to it in international law and practice. Both are presented as alternative language.

Article 2
Grant of Rights

1 Each Party grants to the other Parties the following rights for the conduct of international air transportation by the airlines of the other Parties:

a) the right to fly across its territory without landing;
b) the right to make stops in its territory for non-traffic purposes; and
c) the right, in accordance with the terms of their designations, to perform scheduled and charter international air transportation between points on the following routes:

i) from points behind the territory of the Party designating the airline via the territory of that Party and intermediate points to any point or points in the territory of the Party granting the right and beyond;
ii) for passenger and all-cargo service or services, between the territory of the Party granting the right and any point or points; and

d) the rights otherwise specified in the Agreement.

2. Each designated airline may on any or all flights and at its option:
a) operate flights in either or both directions;
b) combine different flight numbers within one aircraft operation;
c) serve behind, intermediate and beyond points and points in the territories of the Parties on the routes in any combination and in any order;
d) omit stops at any point or points;
e) transfer traffic from any of its aircraft to any of its other aircraft at any point on the routes;
f) serve points behind any point in its territory with or without change of aircraft or flight number and hold out and advertise such services to the public as through services;
g) make stopovers at any points whether within or outside the territory of any Party;
h) carry transit traffic through any other Party's territory; and
i) combine traffic on the same aircraft regardless of where such traffic originates; without directional or geographic limitation and without loss of any right to carry traffic otherwise permissible under the present Agreement.

3. On any international segment or segments of the agreed routes, a designated airline may perform international air transportation without any limitation as to change, at any point on the route, in type or number of aircraft operated; provided that [with the exception of all-cargo services] the transportation beyond such point is a continuation of the transportation from the territory of the Party that has designated the airline and, in the inbound direction, the transportation to the territory of the Party that has designated the airline is a continuation of the transportation from beyond such point.

4. A Party shall authorize cabotage rights for the designated airline(s) of every other Party without restriction.

Article 3
Designation and Authorization

1. Each Party shall have the right to designate as many airlines as it wishes to operate the agreed services in accordance with this Agreement and to withdraw or alter such designation. Such designation shall be transmitted to the other Parties in writing through diplomatic channels [and to the Depository].

2. On receipt of such a designation, and of application from the designated airline, in the form and manner prescribed for operating authorization [and technical permission], each Party shall grant the appropriate operating authorization with minimum procedural delay, provided that:

   a) the airline is under the effective regulatory control of the designating Party; Full liberalization (cont'd) The full liberalization approach refers to as many airlines or no quantitative limit on the number of airlines which can be designated. Full liberalization removes all criteria pertaining to the airline, but requires effective regulatory control by the designating State to ensure compliance with Safety and Security standards. It would also include a "right of establishment" that is a right for non-nationals to establish and operate an airline in the territory of a Party which could then engage in domestic and international air services.

   b) the Party designating the airline is in compliance with the provisions set forth in Article 8 (Safety) and Article 9 (Aviation Security); and

c) the designated airline is qualified to meet other conditions prescribed under the laws and regulations normally applied to the operation of international air transport services by the Party considering the application or applications.

3. On receipt of the operating authorization of paragraph 2, a designated airline may at any time begin to operate the agreed services for which it is so designated, provided that the airline complies with the applicable provisions of this Agreement.

4. Parties granting operating authorizations in accordance with paragraph 2 of this Article shall notify such action to the Depository.]

Article 4
Withholding, revocation and
Limitation of Authorization

1. The aeronautical authorities of each Party shall have the right to withhold the authorizations referred to in Article 3 (Designation and authorization) of this Agreement with respect to an airline designated by any other Party, and to revoke, suspend or impose conditions on such authorizations, temporarily or permanently:
   a) in the event that they are not satisfied that the airline is under the effective regulatory control of the designating State;
   b) in the event of failure of the Party designating the airline to comply with the provisions set forth in Article 8 (Safety) and Article 9 (Aviation security); and

c) in the event of failure that such designated airline is qualified to meet other conditions prescribed under the laws and regulations normally applied to the operation of international air transport services by the Party receiving the designation.

2. Unless immediate action is essential to prevent infringement of the laws and regulations referred to above or unless safety or security requires action in accordance with the provisions of Article 8 (Safety) or Article 9 (Aviation security), the rights enumerated in paragraph 1 of this Article shall be exercised only after consultations between the aeronautical authorities in conformity with Article 33 (Consultations) of this Agreement.

Article 5
Application of Laws

1. The laws and regulations of one Party governing entry into and departure from its territory of aircraft engaged in international air services, or the operation and navigation of such aircraft while within its territory, shall be applied to aircraft of the designated airline of the other Party.

2. The laws and regulations of one Party relating to the entry into, stay in and departure from its territory of passengers, crew and cargo including mail such as those regarding immigration, customs, currency and health and quarantine shall apply to passengers, crew, cargo and mail carried by the aircraft of the designated airline of the other Party while they are within the said territory.

3. Neither Party shall give preference to its own or any other airline over a designated airline of the other Party engaged in similar international air transportation in the application of its immigration, customs, quarantine and similar regulations.

Article 6
Direct transit

Passengers, baggage, cargo and mail in direct transit shall be subject to no more than a simplified control. Baggage and cargo in direct transit shall be exempt from customs duties and other similar taxes.

Article 7
Recognition of Certificates

1. Certificates of airworthiness, certificates of competency and licenses issued or rendered valid by one Party and still in force shall be recognised as valid by the other Party for the purpose of operating the agreed services provided that the requirements under which such certificates and licenses were issued or rendered valid are equal to or above the minimum standards which may be established pursuant to the Convention.

2. If the privileges or conditions of the licences or certificates referred to in paragraph 1 above, issued by the aeronautical authorities of one Party to any person or designated airline or in respect of an aircraft used in the operation of the agreed services, should permit a difference from the minimum standards established under the Convention, and which difference has been filed with the International Civil Aviation Organization, the other Party may request consultations between the aeronautical authorities with a view to clarifying the practice in question.

3. Each Party reserves the right, however, to refuse to recognise for the purpose of flights above or landing within its own territory, certificates of competency and licenses granted to its own nationals by the other Party.

Article 8
Safety

1. Each Party may request consultations at any time concerning the safety standards maintained by the other Party in areas relating to aeronautical facilities, flight crew, aircraft and the operation of aircraft. Such consultations shall take place within thirty days of that request.

2. If, following such consultations, one Party finds that the other Party does not effectively maintain and administer safety standards in the areas referred to in paragraph 1 that meet the Standards established at that time pursuant to the Convention on International Civil Aviation (Doc 7300), the other Party shall be informed of such findings and of the steps considered necessary to conform with the ICAO Standards. The other Party shall then take appropriate corrective action within an agreed time period.

3. Pursuant to Article 16 of the Convention, it is further agreed that, any aircraft operated by, or on behalf of an airline of one Party, on service to or from the territory of another Party, may, while within the territory of the other Party be the subject of a search by the authorized representatives of the other Party, provided this does not cause unreasonable delay in the operation of the aircraft. Notwithstanding the obligations mentioned in Article 33 of the Chicago Convention, the purpose of this search is to verify the validity of the relevant aircraft documentation, the licensing of its crew, and

that the aircraft equipment and the condition of the aircraft conform to the Standards established at that time pursuant to the Convention.

4. When urgent action is essential to ensure the safety of an airline operation, each Party reserves the right to immediately suspend or vary the operating authorization of an airline or airlines of the other Party.

5. Any action by one Party in accordance with paragraph 4 above shall be discontinued once the basis for the taking of that action ceases to exist.

6. With reference to paragraph 2, if it is determined that one Party remains in non-compliance with ICAO Standards when the agreed time period has lapsed, the Secretary General of ICAO should be advised thereof. The latter should also be advised of the subsequent satisfactory resolution of the situation.

Article 9
Aviation Security

1. Consistent with their rights and obligations under international law, the Parties reaffirm that their obligation to each other to protect the security of civil aviation against acts of unlawful interference forms an integral part of this Agreement. Without limiting the generality of their rights and obligations under international law, the Parties shall in particular act in conformity with the provisions of the Convention on Offences and Certain Other Acts Committed on Board Aircraft, signed at Tokyo on 14 September 1963, the Convention for the Suppression of Unlawful Seizure of Aircraft, signed at The Hague on 16 December 1970 and the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, signed at Montreal on 23 September 1971, its Supplementary Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, signed at Montreal on 24 February 1988 as well as with any other convention and protocol relating to the security of civil aviation which both Parties adhere to.

2. The Parties shall provide upon request all necessary assistance to each other to prevent acts of unlawful seizure of civil aircraft and other unlawful acts against the safety of such aircraft, their passengers and crew, airports and air navigation facilities, and any other threat to the security of civil aviation.

3. The Parties shall, in their mutual relations, act in conformity with the aviation security provisions established by ICAO and designated as Annexes to the Convention; they shall require that operators of aircraft of their registry or operators of aircraft who have their principal place of business or permanent residence in their territory and the operators of airports in their territory act in conformity with such aviation security provisions. [Each Party shall advise the other Party of any difference between its national regulations and practices and the aviation security standards of the Annexes. Either Party may request immediate consultations with the other Party at any time to discuss any such differences.]

4. Each Party agrees that such operators of aircraft may be required to observe the aviation security provisions referred to in paragraph 3) above required by the other Party for entry into, departure from, or while within, the territory of that other Party. Each Party shall ensure that adequate measures are effectively applied within its territory to protect the aircraft and to inspect passengers, crew, carry-on items, baggage, cargo and aircraft stores prior to and during boarding or loading. Each Party

shall also give sympathetic consideration to any request from the other Party for reasonable special security measures to meet a particular threat.

5. When an incident or threat of an incident of unlawful seizure of civil aircraft or other unlawful acts against the safety of such aircraft, their passengers and crew, airports or air navigation facilities occurs, the Parties shall assist each other by facilitating communications and other appropriate measures intended to terminate rapidly and safely such incident or threat thereof.

6. Each Party shall have the right, within sixty (60) days following notice (or such shorter period as may be agreed between the aeronautical authorities), for its aeronautical authorities to conduct an assessment in the territory of the other Party of the security measures being carried out, or planned to be carried out, by aircraft operators in respect of flights arriving from, or departing to the territory of the first Party. The administrative arrangements for the conduct of such assessments shall be agreed between the aeronautical authorities and implemented without delay so as to ensure that assessments will be conducted expeditiously.

Article 10
Security of Travel Documents

1. Each Party agrees to adopt measures to ensure the security of their passports and other travel documents.

2. In this regard, each Party agrees to establish controls on the lawful creation, issuance, verification and use of passports and other travel documents and identity documents issued by, or on behalf of, that Party.

3. Each Party also agrees to establish or improve procedures to ensure that travel and identity documents issued by it are of such quality that they cannot easily be misused and cannot readily be unlawfully altered, replicated or issued.

4. Pursuant to the objectives above, each Party shall issue their passports and other travel documents in accordance with ICAO Doc 9303, Machine Readable Travel Documents: Part 1 - Machine Readable Passports, Part 2 - Machine Readable Visas, and/or Part 3 - Size 1 and Size 2 Machine Readable Official Travel Documents.

5. Each Party further agrees to exchange operational information regarding forged or counterfeit travel documents, and to cooperate with the other to strengthen resistance to travel document fraud, including the forgery or counterfeiting of travel documents, the use of forged or counterfeit travel documents, the use of valid travel documents by imposters, the misuse of authentic travel documents by rightful holders in furtherance of the commission of an offence, the use of expired or revoked travel documents, and the use of fraudulently obtained travel documents.

Article 11
Inadmissible and Undocumented
Passengers and Deportees

1. Each Party agrees to establish effective border controls.

2. In this regard, each Party agrees to implement the Standards and Recommended Practices of Annex 9 (Facilitation) to the Chicago Convention concerning inadmissible and undocumented passengers and deportees in order to enhance cooperation to combat illegal migration.

3. Pursuant to the objectives above, each Party agrees to issue, or to accept, as the case may be, the letter relating to "fraudulent, falsified or counterfeit travel documents or genuine documents presented by imposters" set out in Appendix 9 b) to Annex 9, when taking action under relevant paragraphs of Chapter 3 of the Annex regarding the seizure of fraudulent, falsified or counterfeit travel documents.

Article 12
User Charges

1. Neither Party shall impose or permit to be imposed on the designated airlines of the other Party user charges higher than those imposed on its own airlines operating similar international services.

2. Each Party shall encourage consultations on user charges between its competent charging authority [or airport or air navigation service provider] and airlines using the

service and facilities provided by those charging authorities [or service provider], where practicable through those airlines' representative organisations. Reasonable notice of any proposals for changes in user charges should be given to such users to enable them to express their views before changes are made. Each Party shall further encourage its competent charging authority [or service provider] and such users to exchange appropriate information concerning user charges.

3. Each Party shall encourage consultations between the competent charging authorities or bodies in its territory and the airlines using the services and facilities, and shall encourage the competent authorities or bodies and the airlines to exchange such information as may be necessary to permit an accurate review of the reasonableness of the charges in accordance with the principles in paragraphs 1 and 2. Each Party shall encourage the competent charging authorities to provide users with reasonable notice of any proposal for changes in user charges to enable users to express their views before changes are made.

4. Neither Party shall be held, in dispute resolution procedures pursuant to Article 34 (Settlement of Disputes), to be in breach of a provision of this Article, unless:
   a) it fails to undertake a review of the charge or practice that is the subject of complaint by the other Party within a reasonable amount of time; or
   b) following such a review it fails to take all steps within its power to remedy any charge or practice that is inconsistent with this Article.

5. Airports, airways, air traffic control and air navigation services, aviation security, and other related facilities and services that are provided in the territory of one Party shall be available for use by the airlines of the other Party on terms no less favourable than the most favourable terms available to any airline engaged in similar international air services at the time arrangements for use are made.

Article 13
Customs Duties

1. Each Party shall on the basis of reciprocity exempt a designated airline of the other Party to the fullest extent possible under its national law from [import restrictions,] customs duties, excise taxes, inspection fees and other national duties and charges [not based on the cost of services provided on arrival,]on aircraft, fuel, lubricating oils, consumable technical supplies, spare parts including engines, regular aircraft equipment, aircraft stores and other items [such as printed ticket stock, air waybills, any printed material which bears the insignia of the company printed thereon and usual publicity material distributed free of charge by that designated airline] intended for use or used solely in connection with the operation or servicing of aircraft of the designated airline of such other Party operating the agreed services.

2. The exemptions granted by this article shall apply to the items referred to in paragraph 1:
   a) introduced into the territory of the Party by or on behalf of the designated airline of the other Party;
   b) retained on board aircraft of the designated airline of one Party upon arrival in or leaving the territory of the other Party; or
   c) taken on board aircraft of the designated airline of one Party in the territory of the other Party and intended for use in operating the agreed services; whether or not such items are used or consumed wholly within the territory of the Party granting the exemption, provided the ownership of such items is not transferred in the territory of the said Party.

3. The regular airborne equipment, as well as the materials and supplies normally retained on board the aircraft of a designated airline of either Party, may be unloaded in the territory of the other Party only with the approval of the customs authorities of that territory. In such case, they may be placed under the supervision of the said authorities up to such time as they are re-exported or otherwise disposed of in accordance with customs regulations.

Article 14
Taxation

1. Profits from the operation of the aircraft of a designated airline in international traffic shall be taxable only in the territory of the Party in which the place of effective management of that airline is situated.

2. Capital represented by aircraft operated in international traffic by a designated airline and by movable property pertaining to the operation of such aircraft shall be taxable only in the territory of the Party in which the place of effective management of the airline is situated.

3. Where a special agreement for the avoidance of double taxation with respect to taxes on income and on capital exists between the Parties, the provisions of the latter shall prevail.

4. Gains from the alienation of aircraft operated in international traffic and movable property pertaining to the operation of such aircraft which are received by an airline of one Party shall be exempt from any tax on gains imposed by the Government of the other Party.

5. Each Party shall on a reciprocal basis grant relief from value added tax or similar indirect taxes on goods and services supplied to the airline designated by the other Party and used for the purposes of its operation of international air services. The tax relief may take the form of an exemption or a refund.

Article 15
Fair Competition

Each designated airline shall have a fair competitive environment under the competition laws of the Parties.

Article 16
Capacity

Capacity offered on air services shall be subject to Article 15 (Fair competition).

1. Each Party shall allow each designated airline to determine the frequency and capacity of the international air transportation it offers based on commercial considerations of the marketplace.

2. No Party shall unilaterally limit the volume of traffic, frequency, or regularity of service, or the aircraft type or types operated by the designated airlines of any other Party, except as may be required for customs, technical, operational, or environmental reasons under uniform conditions consistent with Article15 of the Convention.

3. No Party shall impose on another Party's designated airlines a first refusal requirement, uplift ratio, no-objection fee, or any other requirement with respect to the capacity, frequency or traffic which would be inconsistent with the purposes of this Agreement.

4. No Party shall require the filing of schedules, programmes for charter flights, or operational plans by airlines of the other Party for approval, except as may be required on a non-discriminatory basis to enforce uniform conditions as foreseen by paragraph 2 of this Article or as may be specifically authorized in an Annex to this Agreement. If a Party requires filings for information purposes, it shall minimize the administrative burdens of filing requirements and procedures on air transportation intermediaries and on designated airlines of the other Party.

Article 17
Tariffs (Pricing)

Prices (Tariffs) shall be subject to Article 15 (Fair competition)

Prices (tariffs) charged by airlines shall not be required to be filed with, or approved by, any Party.

Article 18
Safeguards

1. The Parties agree that the following airline practices may be regarded as possible unfair competitive practices which may merit closer examination:
    a) charging fares and rates on routes at levels which are, in the aggregate, insufficient to cover the costs of providing the services to which they relate;
    b) the addition of excessive capacity or frequency of service;
    c) the practices in question are sustained rather than temporary;
    d) the practices in question have a serious economic effect on, or cause significant damage to, another airline;
    e) the practices in question reflect an apparent intent or have the probable effect, of crippling, excluding or driving another airline from the market; and
    f) behaviour indicating an abuse of dominant position on the route.

2. If the aeronautical authorities of one Party consider that an operation or operations intended or conducted by the designated airline of the other Party may constitute unfair competitive behaviour in accordance with the indicators listed in paragraph 1, they may request consultation in accordance with Article [33 on Consultation] with a view to resolving the problem. Any such request shall be accompanied by notice of the reasons for the request, and the consultation shall begin within 15 days of the request.

3. If the Parties fail to reach a resolution of the problem through consultations, either Party may invoke the dispute resolution mechanism under Article [34] to resolve the dispute.

Article 19
Competition Laws

1. The Parties shall inform each other about their competition laws, policies and practices or changes thereto, and any particular objectives thereof, which could affect the operation of air transport services under this agreement and shall identify the authorities responsible for their implementation.

2. the Parties shall, to the extent permitted under their own laws and regulations, assist each other's airlines by providing guidance as to the compatibility of any proposed airline practice with their competition laws, policies and practices.

3. The Parties shall notify each other whenever they consider that there may be incompatibility between the application of their competition laws, policies and practices and the matters related to the operation of this Agreement; the consultation process contained in this Agreement shall, if so requested by either Party, be used to determine whether such a conflict exists and to seek ways of resolving or minimizing it.

4. The Parties shall notify one another of their intention to begin proceedings against each other's airline(s) or of the institution of any relevant private legal actions under their competition laws which may come to their attention.

5. Without prejudice to the right of action of either Party the consultation process contained in this agreement shall be used whenever either Party so requests and should aim to identify the respective interests of the Parties and the likely implications arising from the particular competition law action.

6. The Parties shall endeavour to reach agreement during such consultations, having due regard to the relevant interests of each Party and to alternative means which might also achieve the objectives of that competition law action.

7. In the event agreement is not reached, each Party shall, in implementing its competition laws, policies and practices, give full and sympathetic consideration to the views expressed by the other Party and shall have regard to international comity, moderation and restraint.

8. The Party under whose competition laws a private legal action has been instituted shall facilitate access by the other Party to the relevant judicial body and/or, as appropriate, provide information to that body. Such information could include its own foreign relations interests, the interests of the other Party as notified by that Party and, if possible, the results of any consultation with that other Party concerning the action.

9. The Parties shall cooperate, to the extent not precluded by their national laws or policies and in accordance with any applicable international obligations, in allowing the disclosure by their airlines or other nationals of information pertinent to a competition law action to the competent authorities of each other, provided that such cooperation or disclosure would not be contrary to their significant national interests.

10. While an action taken by the competition law authorities of one Party is the subject of consultations with the other Party, the Party in whose territory the action is being taken shall, pending the outcome of these consultations, refrain from requiring the disclosure of information situated in the territory of the other Party and that other Party shall refrain from applying any blocking legislation.

Article 20
Currency Conversion and Remittance of Earnings

Each Party shall permit airline(s) of the other Party to convert and transmit abroad to the airline(s) choice of State, on demand, all local revenues from the sale of air transport services and associated activities directly linked to air transport in excess of sums locally disbursed, with conversion and remittance permitted promptly without restrictions, discrimination or taxation in respect thereof at the rate of exchange applicable as of the date of the request for conversion and remittance.

Article 21
Sale and Marketing of Air Service Products

1. Each Party shall accord airlines of the other Party the right to sell and market international air services and related products in its territory (directly or through agents or other intermediaries of the airline's choice), including the right to establish offices, both on-line and off-line.

2. Each airline shall have the right to sell transportation in the currency of that territory or, at its discretion, in freely convertible currencies of other countries, and any person shall be free to purchase such transportation in currencies accepted by that airline.

Article 22
Non-National Personnel and Access to Local Services

Each Party shall permit designated airlines of the other Party to:

a) bring in to its territory and maintain non-national employees who perform managerial, commercial, technical, operational and other specialist duties which are required for the provision of air transport services, consistent with the laws and regulations of the receiving State concerning entry, residence and employment; and

b) use the services and personnel of any other organization, company or airline operating in its territory and authorized to provide such service.

Article 23
Change of Gauge

On any international segment or segments of the agreed routes, a designated airline may perform international air transportation without any limitation as to change, at any point on the route, in type or number of aircraft operated; provided that [with the exception of all-cargo services] the transportation beyond such point is a continuation of the transportation from the territory of the Party that has designated the airline and, in the inbound direction, the transportation to the territory of the Party that has designated the airline is a continuation of the transportation from beyond such point.

Article 24
Ground Handling

1. Subject to applicable safety provisions, including ICAO Standards and Recommended Practices (SARPs) contained in Annex 6, each Party shall authorize airline(s) of the other Party, at each airline's choice, to:
    a) perform its own ground handling services;
    b) handle another or other air carrier(s);
    c) join with others in forming a service-providing entity; and/or
    d) select among competing service providers.

2. An air carrier is permitted to choose freely from among the alternatives available and to combine or change its option, except where this is demonstrably impractical and also where constrained by relevant safety and security considerations, and (with the exception of self-handling in a) above) by the scale of airport operations being too small to sustain competitive providers.

3. Parties would always be required to take the necessary measures to ensure reasonable cost-based pricing and fair and equal treatment for air carrier(s) of the other Party/Parties.

Article 25
Codesharing/Co-operative Arrangements

1. In operating or holding out the authorized services on the agreed routes, any designated airline of one Party may enter into cooperative marketing arrangements such as joint venture, blocked space or codesharing arrangements, with:
    a) an airline or airlines of either Party;
    b) an airline or airlines of a third country; and
    b) a surface transportation provider of any country,

   provided that all airlines in such arrangements 1) hold the appropriate authority and 2) meet the requirements normally applied to such arrangements.

Article 26
Leasing

1. Either Party may prevent the use of leased aircraft for services under this agreement which does not comply with Articles 8 [(Safety)] and 9 (Security).

2. Subject to paragraph 1 above, the designated airlines of each Party may use aircraft leased from other airlines, provided all participants in such arrangements hold the appropriate authority and meet the requirements applied to such arrangements.

Article 27
Intermodal Services

Each designated airline may use surface modes of transport without restriction in conjunction with the international air transport of passengers and cargo.

Article 28
Computer Reservation Systems (CRS)

Each Party shall apply the ICAO Code of Conduct for the Regulation and Operation of Computer Reservation Systems within its territory.

Article 29
Ban on Smoking

1. Each Party shall prohibit or cause their airlines to prohibit smoking on all flights carrying passengers operated by its airlines between the territories of the Parties. This prohibition shall apply to all locations within the aircraft and shall be in effect from the time an aircraft commences enplanement of passengers to the time deplanement of passengers is completed.

2. Each Party shall take all measures that it considers reasonable to secure compliance by its airlines and by their passengers and crew members with the provisions of this Article, including the imposition of appropriate penalties for non-compliance.

Article 30
Environmental Protection

The Parties support the need to protect the environment by promoting the sustainable development of aviation. The Parties agree with regard to operations between their respective territories to comply with the ICAO Standards and Recommended Practices (SARPs) of Annex and the existing ICAO policy and guidance on environmental protection.

Article 31
Statistics

The aeronautical authorities of each Party shall provide [or cause its designated airline or airlines to provide] the aeronautical authorities of the other Party, [upon request,] periodic or other statements of statistics as may be reasonably required for the purpose of reviewing the capacity provided on the agreed services operated by the designated airline(s) of the first Party.

Article 32
Approval of Schedules

1. The designated airline of each Party shall submit its envisaged flight schedules for approval to the aeronautical authorities of the other Party at least thirty (30) days prior to the operation of the agreed services. The same procedure shall apply to any modification thereof.

2. For supplementary flights which the designated airline of one Party wishes to operate on the agreed services outside the approved timetable, that airline must request prior permission from the aeronautical authorities of the other Party. Such requests shall usually be submitted at least two (2) working days prior to the operation of such flights. This provision is common to traditional agreements where capacity is determined by both Parties in advance. There is a requirement for the designated airlines to submit to the aeronautical authorities, prior to the operation of the services, the agreed flight schedules including timetables, the frequency of the services and the types of aircraft to be used, as well as any modifications or supplementary flights.

Article 33
Consultations

1. Either Party may, at any time, request consultation on the interpretation, application, implementation or amendment of this Agreement or compliance with this Agreement.

2. Such consultations [which may be through discussion or by correspondence] shall begin within a period of 60 [30] days from the date the other Party receives a [written or oral] request, unless otherwise agreed by the Parties.

Article 34
Settlement of Disputes

1. Any dispute arises between the Parties relating to the interpretation or application of this Agreement [except those that may arise under Article 15 (Fair competition), Article 8 (Safety), Article 17 (Tariffs/Pricing)], the Parties shall in the first place endeavour to settle it by consultations and negotiation.

2. Any dispute which cannot be resolved by consultations, may at the request of either Party to the agreement be submitted to a mediator or a dispute settlement panel. Such a mediator or panel may be used for mediation, determination of the substance of the dispute or to recommend a remedy or resolution of the dispute.

3. The Parties shall agree in advance on the terms of reference of the mediator or of the panel, the guiding principles or criteria and the terms of access to the mediator or the panel. They shall also consider, if necessary, providing for an interim relief and the possibility for the participation of any Party that may be directly affected by the dispute, bearing in mind the objective and need for a simple, responsive and expeditious process.

4. A mediator or the members of a panel may be appointed from a roster of suitably qualified aviation experts maintained by ICAO. The selection of the expert or experts shall be completed within fifteen (15) days of receipt of the request for submission to a mediator or to a panel. If the Parties fail to agree on the selection of an expert or experts, the selection may be referred to the President of the Council of ICAO. Any expert used for this mechanism should be adequately qualified in the general subject matter of the dispute.

5. A mediation should be completed within sixty (60) days of engagement of the mediator or the panel and any determination including, if applicable, any recommendations, should be rendered within sixty (60) days of engagement of the expert or experts. The Parties may agree in advance that the mediator or the panel may grant interim relief to the complainant, if requested, in which case a determination shall be made initially.

6. The Parties shall cooperate in good faith to advance the mediation and to implement the decision or determination of the mediator or the panel, unless they otherwise agree in advance to be bound by decision or determination. If the Parties agree in advance to request only a determination of the facts, they shall use those facts for resolution of the dispute.

7. The costs of this mechanism shall be estimated upon initiation and apportioned equally, but with the possibility of re-apportionment under the final decision.

8. The mechanism is without prejudice to the continuing use of the consultation process, the subsequent use of arbitration, or Termination under Article 37

9. If the Parties fail to reach a settlement through mediation, the dispute may, at the request of either Party, be submitted to arbitration in accordance with the procedures set forth below.

Article 35
Amendments

1. The Agreement may be amended in accordance with the following procedures:
   a) if agreed by at least a simple majority of all Parties as of the date of proposal of the amendment, negotiations shall be held to consider the proposal;

   b) unless otherwise agreed, the Party proposing the amendment shall host the negotiations, which shall begin not more than 90 days after agreement is reached to hold such negotiations. All Parties shall have a right to participate in the negotiations;

   c) if adopted by at least a simple majority of the Parties attending such negotiations, the Depository shall then prepare and transmit a certified copy of the amendment to the Parties for their acceptance;

   d) any amendment shall enter into force, as between the Parties which have accepted it, 30 days following the date on which the Depository has received written notification of acceptance from a simple majority of the Parties; and

   e) following entry into force of such an amendment, it shall enter into force for any other Party 30 days following the date the Depository receives written notification of acceptance from that

2. In lieu of the procedures set forth in paragraph 1, the Agreement may be amended in accordance with the following procedures:

   a) if all Parties as of the time of proposal of the amendment give written notice through diplomatic or other appropriate channels to the Party proposing the amendment of their consent to its adoption, the Party proposing the amendment shall so notify the Depository, which shall then prepare and transmit a certified copy of such amendment to all of the Parties for their acceptance; and

   b) an amendment so adopted shall enter into force for all Parties 30 days following the date on which the Depository has received written notification of acceptance from all of the Parties.

Article 36
Multilateral Agreements

If a multilateral agreement concerning air transport comes into force in respect of both Parties, the present Agreement shall be [deemed to be] amended so as [so far as is necessary] to conform with the provisions of that multilateral agreement.

Article 37
Termination

Either Party may, at any time, give notice in writing, through diplomatic channels, to the other Party of its [intention] [decision] to terminate this Agreement. Such notice shall be simultaneously communicated to ICAO. This Agreement shall terminate [at midnight (at the place of receipt of the notice) immediately before the first anniversary of] [twelve months after] the date of receipt of the notice by the other Party, unless the notice is withdrawn by agreement before the end of this period. [In the absence of acknowledgement of receipt by the other Party, the notice shall be deemed to have been received fourteen (14) days after receipt of the notice by ICAO].

Article 38
Registration with ICAO

This Agreement and any amendment thereto shall be registered upon its signature with the International Civil Aviation Organization by (name of the registering Party).

Article 39
Entry into force

This Agreement shall [be applied provisionally from the date of its signature and shall] enter into force [thirty (30) days after both Parties have notified each other through diplomatic channels that their constitutional procedures for the entry into force of this agreement have been completed] [from the date on which the exchange of diplomatic notes between the Parties has been completed].

Article 40
Exceptions

In addition to the rights in the Agreement, the Parties to a Protocol to this Agreement also grant the rights for their designated airlines to perform:

a) scheduled and charter international air transportation in passenger and combination services between the territory of the party granting the rights and any point or points; and

b) scheduled and charter international air transportation between points in the territory of the Party granting the rights.

Article 41
Existing Agreements

Upon entry into force of this Agreement between one Party and any other Party, any bilateral air services agreement existing between them at the time of such entry into force shall be superseded by this Agreement.

Article 42
Review

1. The Agreement shall be subject to review every [number of years] in order to determine whether any amendments are required. An earlier review may take place if requested by [number of Parties] of the Parties.

2. After consultation with the Parties, the Depository shall notify the Parties of the agreed date and the procedures for the review of the Agreement. Such notice should take place [number of days] days before the meeting.

Article 43
Withdrawal

1. Any Party may withdraw from this Agreement by giving written notice of withdrawal to the Depository who shall within [agreed number of days] of receipt of the notification of withdrawal notify the other Parties.

2. The withdrawal shall be effective 12 months after receipt of the notice by the Depository, unless the Party withdraws its notice by written communication to the Depository within the 12-month period.

3. If, as a result of withdrawals, the number of Parties to this Agreement is less than [an agreed number], this Agreement shall cease to be in force from the date on which the last of such withdrawals becomes effective.

Article 44
Depository

1. The original of this Agreement shall be deposited with [the Party or regional entity agreed to], which shall be designated as the Depository of the Agreement.

2. The Depository shall transmit certified copies of the Agreement to all Parties of the Agreement and to any States that may subsequently accede to the Agreement.

3. Following entry into force of this Agreement, the Depository shall transmit a certified true copy of this Agreement to the Secretary General of the United Nations for registration and publication in accordance with Article 102 of the Charter of the United Nations [and to the Secretary General of the International Civil Aviation Organization in accordance with Article 83 of the Convention.] The Depository shall likewise transmit certified true copies of any amendments which enter into force.

4. The Depository shall make available to the Parties copies of any arbitral decision or award issued under Article 34 (Settlement of disputes) of this Agreement.

5. The Depository shall maintain a centralized register of airline designations and operating authorizations in accordance with Article 3 (Designation and authorization), paragraph 4 of this Agreement.]

Article 45
Signature and Ratification

1. The Agreement shall be open for signature by the [Government of the Parties to the Agreement]

2. The Agreement shall be subject to ratification. Instruments of ratification shall be deposited with the Depository.

Article 46
Accession

After this Agreement has entered into force any State which is a Party to the aviation security conventions listed in Article 9 (Aviation security) may accede to this Agreement by deposit of an instrument of accession with the Depository.

Article 47
Entry into Force

1. This Agreement shall enter into force on the[agreed day] from the date of deposit of the [agreed number] instrument of ratification, and thereafter for each Party [number of days] days after the deposit of its instrument of ratification or accession.

2. The Depository shall inform each Party of the date of entry into force of this Agreement.

Annex I
Route schedules

Airlines of each Party designated under this Annex shall be entitled to provide air transportation between points on the following routes:

A. Routes to be operated by the designated airline (or airlines) of Party A:
Points to, from and within the territory of Party B.

B. Routes to be operated by the designated airline (or airlines) of Party B:
Points to, from and within the territory of Party A.

Section 2
Operational flexibility

The designated airlines of either Party may, on any or all flights and at its option:

1. operate flights in either or both directions;
2. combine different flight numbers within one aircraft operation;
3. serve intermediate and beyond points in the territories of the Parties on the routes in any combination and in any order;
4. omit stops at any point or points;
5. transfer traffic (including codesharing operations) from any of its aircraft to any of its other aircraft at any point on the routes; and
6. serve points behind any point in its territory with or without change of aircraft or flight number and may hold out and advertise such services to the public as through services; without directional or geographic limitation and without loss of any right to carry traffic otherwise permissible under the present Agreement; provided that, (with the exception of all-cargo services) the service serves a point in the territory of the Party designating the airlines.

Annex II
Non-Scheduled/Charter Operations

Section 1
Airlines of each Party designated under this Annex shall, in accordance with the terms of their designation, have the right to carry international charter traffic of passengers (and their accompanying baggage) and/or cargo (including, but not limited to, freight forwarder, split, and combination (passenger/cargo) charters):

Between any point or points in the territory of the Party that has designated the airline and any point or points in the territory of the other Party; and

Between any point or points in the territory of the other Party and any point or points in a third country or countries, provided that, except with respect to cargo charters, such service constitutes part of a continuous operation, with or without a change of aircraft, that includes service to the homeland for the purpose of carrying local traffic between the homeland and the territory of the other Party.

In the performance of services covered by this Annex, airlines of each Party designated under this Annex shall also have the right: (1) to make stopovers at any points whether within or outside of the territory of either Party; (2) to carry transit traffic through the other Party's territory; (3) to combine on the same aircraft traffic originating in one Party's territory, traffic originating in the other Party's territory, and traffic originating in third countries; and (4) to perform international air transportation without any limitation as to change, at any point on the route, in type or number of aircraft operated; provided that, except with respect to cargo charters, in the outbound direction, the transportation beyond such point is a continuation of the transportation from the territory of the Party that has designated the airline and in the inbound direction, the transportation to the territory of the Party that has designated the airline is a continuation of the transportation from beyond such point.

Each Party shall extend favourable consideration to applications by airlines of the other Party to carry traffic not covered by this Annex on the basis of comity and reciprocity.

Section 2
Any airline designated by either Party performing international charter air transportation originating in the territory of either Party, whether on a one-way or round-trip basis, shall have the option of complying with the charter laws, regulations, and rules either of its homeland or of the other Party. If a Party applies different rules, regulations, terms, conditions, or limitations to one or more of its airlines, or to airlines of different countries, each designated airline shall be subject to the least restrictive of such criteria.

However, nothing contained in the above paragraph shall limit the rights of either Party to require airlines designated under this Annex by either Party to adhere to requirements relating to the protection of passenger funds and passenger cancellation and refund rights.

Section 3
Except with respect to the consumer protection rules referred to in the preceding paragraph above, neither Party shall require an airline designated under this Annex by the other Party, in respect of the carriage of traffic from the territory of that other Party or of a third country on a one-way or round-trip basis, to submit more than a declaration of conformity with the applicable laws, regulations and rules referred to under section 2 of this Annex or of a waiver of these laws, regulations, or rules granted by the applicable aeronautical authorities.

Annex III
Air Cargo Services

Every designated airline when engaged in all cargo transportation as scheduled or non-scheduled services may provide such services to and from the territory of each Party, without restriction as to frequency, capacity, routing, type of aircraft, and origin or destination of cargo.

Annex IV
Transitional Measures

The following transitional measures shall expire on (date), or such earlier date as is agreed upon by the Parties:

1. Notwithstanding the provisions of Article ____ (or Annex ____), the designated airline (or airlines) of Party A (or each Party) may (shall) .....

2. Notwithstanding the provisions of Article ____ (or Annex ____), the designated airline (or airlines) of Party A (or each Party) may (shall) .... as follows:

    a) From (date) through (date), ...; and
    b) From (date) through (date), ...

3. Notwithstanding the provisions of Article ____ (or Annex ____), the following provisions shall govern .....

Appendix 6 - Airline Fleets - 2002

Bativa Air

Total Fleet 6 Operating Fleet 6	No in Fleet	On Order	Stored	Leased
737-400	2	0	0	2
737-200	3	0	0	3
F.28	1	0	0	1

Bangkok Airways

Total Fleet 13 Operating Fleet 13	No in Fleet	On Order	Stored	Leased
ATR-72	9	5	0	3
717-200	4	0	0	4

Bouraq Indonesia

Total Fleet 11 Operating Fleet 11	No in Fleet	On Order	Stored	Leased
MD-82	3	0	0	3
737-200	6	0	0	4
F.28	2	0	0	2

Cebu Pacific Air

Total Fleet 17 Operating Fleet 17	No in Fleet	On Order	Stored	Leased
DC9-30	14	0	0	3
757-200 (RR)	3	0	0	3

Garuda

Total Fleet 53 Operating Fleet 53	No in Fleet	On Order	Stored	Leased
A.330-300 (RR)	6	3	0	6
DC-10-30	5	0	0	0
737-300	9	0	0	4
737-400	16	0	0	9
737-500	5	0	0	4
737-700	0	18	0	0
747-200B (P&W)	4	0	0	0
747-400 (GE)	3	0	0	1
777-200ER (GE)	0	6	0	0
F.28	5	0	0	0

Lao Aviation (Now Lao Airlines)

Total Fleet 9 Operating Fleet 9	No in Fleet	On Order	Stored	Leased
ATR-72	2	0	0	1
An-24RV	1	0	1	0
Y-7	2	0	0	0
Y-12II	4	0	1	0

Myanmar Airways

Total Fleet 12 Operating Fleet 10	No in Fleet	On Order	Stored	Leased
F.27	7	0	1	0
F.27RF	1	0	1	0
F.28	4	0	0	0
CN-212	0	2	0	0

Orient Thai

Total Fleet 6 Operating Fleet 6	No in Fleet	On Order	Stored	Leased
747-100	1	0	0	1
747-200B (P&W)	3	0	0	3
L-1011-1 (Group 3)	2	0	0	1

Pacific Airlines

Total Fleet 4 Operating Fleet 4	No in Fleet	On Order	Stored	Leased
A.310-320 (P&W)	1	0	0	1
A.321-130 (IAE)	2	0	0	2
MD-90-30	1	0	0	1

Pelita Air Services

Total Fleet 28 Operating Fleet 24	No in Fleet	On Order	Stored	Leased
RJ85	1	0	0	0
DHC-7	6	0	1	0
CASA 212	2	0	2	0
Fokker 100	4	0	0	4
Fokker 50	3	0	0	3
F.28	2	0	0	0
CN-212	10	0	1	0

Philippine Airlines

Total Fleet 29 Operating Fleet 29	No in Fleet	On Order	Stored	Leased
A.320-210 (CFM)	3	0	0	3
A.330-300 (GE)	8	0	0	8
A.340-310 (CFM)	4	0	0	4
737-300	7	0	0	6
737-400	3	0	0	3
737-400 (GE)	3	4	0	0
747-400 Combi (GE)	1	0	0	1

Royal Brunei

Total Fleet 9 Operating Fleet 9	No in Fleet	On Order	Stored	Leased
A.319-130 (IAE)	0	2	0	0
757-200 (RR)	1	0	0	0
767-300ER (GE)	2	0	0	2
767-300ER (P&W)	6	0	0	0

Silk Air

Total Fleet 9 Operating Fleet 9	No in Fleet	On Order	Stored	Leased
A.319-130 (IAE)	4	2	0	0
A.320-230 (IAE)	5	5	0	1

Singapore Airlines

Total Fleet 95 Operating Fleet 95	No in Fleet	On Order	Stored	Leased
A.310-320 (P&W)	9	0	0	2
A.340-310 (CFM)	5	2	0	0
A.340-540 (RR)	0	5	0	0
A.380-800 (RR)	0	10	0	0
747-400 (P&W)	39	0	0	20
777-200ER (RR)	34	16	0	1
777-300 (RR)	8	1	0	0

Singapore Cargo

Total Fleet 11 Operating Fleet 11	No in Fleet	On Order	Stored	Leased
747-400F (P&W)	11	6	0	2

Thai Airways International

Total Fleet 81 Operating Fleet 81	No in Fleet	On Order	Stored	Leased
ATR-72	2	0	0	0
A.300-600 (GE)	6	0	0	4
A.300-600R (GE)	2	0	0	0
A.300-620R (P&W)	13	0	0	9
A.330-320 (P&W)	12	0	0	3
MD-11 (GE)	4	0	0	0
737-400	10	0	0	7
747-300 (GE)	2	0	0	0
747-400 (GE)	16	0	0	2
777-200 (RR)	8	0	0	4
777-300 (RR)	6	0	0	0

Vietnam Airlines

Total Fleet 30 Operating Fleet 30	No in Fleet	On Order	Stored	Leased
ATR-72	8	0	0	3
A.320-210 (CFM)	10	0	0	10
A.321-130 (IAE)	2	0	0	2
767-300ER (GE)	4	0	0	4
767-300ER (P&W)	4	0	0	4
777-200ER (GE)	0	2	0	0
777-200ER (P&W)	0	4	0	0
Fokker 70	2	0	0	0

Source: Air Transport World (WAS. D.C.) "The World Airline Report", July 2003.

Appendix 7 - Performance Of ASEAN Carriers

ASEAN CARRIERS TOTAL INTERNATIONAL PASSENGER OPERATIONS – BY AIRLINE

Airline	Passengers Carried ('000)			Revenue Pax KMS – RPK ('000)			Available Seat KMS-ASK ('000)			Pax Load Factor (%)	
	FY 2000/01	FY 2001/02	% Chg.	FY 2000/01	FY 2001/02	% Chg.	FY 2000/01	FY2001/02	% Chg.	FY 2000/01	FY 2001/02
BI	920	1,026	11.5	3,279,111	3,697,81	12.8	5,092,969	5,540,465	8.8	64.4	66.7
GA	2,217	2,379	7.3	12,775,000	13,152,000	3.0	16,769,000	18,684,000	11.4	76.2	70.4
MH	7,891	7,088	-10.2	33,794,083	30,145,788	-10.8	45,531,288	46,053,525	1.1	74.2	65.5
PR	2,359	2,548	8.0	10,977,958	11,526,605	5.0	15,884,795	16,315,712	2.7	69.1	70.6
SQ	15,002	14,764	-1.6	71,118,400	69,994,500	-1.6	92,648,000	94,558,500	2.1	76.8	74.0
TG	10,879	11,625	6.9	37,835,173	41,549,264	9.8	50,329,185	55,198,133	9.7	75.2	75.3
VN	1,192	1,473	23.6	3,131,558	4,081,44	30.3	4,159,379	5,620,992	35.1	75.3	72.6
MI	699	775	10.9	1,056,184	1,173,46	11.1	1,615,365	1,931,318	19.6	65.4	60.8

Source: Association of Asia Pacific Airlines (AAPA)

ASEAN CARRIERS TOTAL INTERNATIONAL FREIGHT OPERATIONS – BY AIRLINE

Airline	Freight Tonnes Carried			Revenue Tonne KMS – RTK ('000)			Available Tonnes KMS-ATK ('000)			Overall Load Factor (%)	
	FY 2000/01	FY 2001/02	% Chg.	FY 2000/01	FY 2001/02	% Chg.	FY 2000/01	FY2001/02	% Chg.	FY 2000/01	FY 2001/02
BI	29,845	29,500	-1.2	428,259	470,110	9.8	741,433	780,037	5.2	57.8	60.3
GA	64,278	64,155	-0.2	1,345,000	1,572,000	16.9	2,321,000	2,661,000	14.6	57.9	59.1
MH	194,131	195,733	0.8	4,255,765	4,095,598	-3.8	6,424,047	6,119,859	-4.7	66.2	66.9
PR	62,130	51,132	-17.7	1,441,069	1,461,505	1.4	2,233,020	2,253,974	0.9	64.5	64.8
SQ	678,313	746,966	10.1	10,429,852	10,182,384	-2.4	14,594,398	14,738,353	1.0	71.5	69.1
TG	439,948	433,401	-1.5	5,117,803	5,455,075	6.6	7,078,518	7,803,193	10.2	72.3	69.9
VN	22,891	25,033	9.4	381,557	478,541	25.4	599,778	786,025	31.1	63.6	60.9
MH Cargo	86,331	67,179	-22.2	724,242	644,350	-11.0	1,349,467	1,073,817	-20.4	53.7	60.0
MI	9,275	10,918	17.7	112,794	116,304	3.1	213,004	255,461	19.9	53.0	45.5

Source: AAPA

PRINCIPAL ASEAN CARRIERS RANKED BY PASSENGERS CARRIED

Airline	Passengers Carried ('000)			Revenue Pax KMS – RPK ('000)			Available Seat KMS-ASK ('000)			Passenger Load Factor (%)
	FY 2001/02	% Chg.	Market Share %	FY 2001/02	% Chg.	Market Share %	FY2001/02	% Chg.	Market Share %	FY 2001/02
SQ	14,764	-1.6	35.44	69,994,500	-1.6	39.25	94,558,500	2.1	38.77	74.0
TG	11,625	6.9	27.90	41,549,264	9.8	23.30	55,198,133	9.7	22.63	75.3
MH	7,088	-10.2	17.01	30,145,788	-10.8	16.91	46,053,525	1.1	18.88	65.5
PR	2,548	8.0	6.12	11,526,605	5.0	6.46	16,315,712	2.7	6.69	70.6
GA	2,379	7.3	5.71	13,152,000	3.0	7.38	18,684,000	11.4	7.66	70.4
VN	1,473	23.6	3.53	4,081,447	30.3	2.29	5,620,992	35.1	2.30	72.6
BI	1,026	11.5	2.46	3,697,812	12.8	2.07	5,540,465	8.8	2.27	66.7
MI	775	10.9	1.86	1,173,462	11.1	0.66	1,931,318	19.6	0.79	60.8
Total	41,658	-	-	175,320,878	-	-	243,902,645	-	-	-

Source: AAPA

AIRLINE FINANCIAL RESULTS - 2002

Airline	Total Operating Revenue ('000) $	2002/2001 % Chg.	Total Operating Expense ('000) $	2002/2001 % Chg.	Operating profit or (loss) ('000) $		Income or (loss) ('000) $	
					2002	2001	2002	2001
GA	1,059,207	5.1	1,014,708	4.6	44,489	38,305	68,575	(12,739)
MH	2,330,616	0.0	2,316,412	-7.4	14,205	(229,967)	89,200	(219,788)
BI	199,784	-	229,933	-	(30,149)	-	(23,178)	-
SIA Group	5,930,460	12.1	5,526,016	15.8	404,444	521,474	600,547	356,279
TG	2,976,500	-0.1	2,545,313	-5.7	431,200	281,900	234,900	44,500

Source: Air Transport World (WAS. D.C.) "The World Airline Report", July 2003.

Airline Codes

BI	Royal Brunei Airlines	PR	Philippine Airlines
GA	Garuda Indonesia	SQ	Singapore Airlines
MH	Malaysia Airlines	TG	Thai Airways International
MI	Silk Air	VN	Vietnam Airlines

Appendix 8 - Air Transport Data

AIRPORT INTERNATIONAL SCHEDULED PASSENGER TRAFFIC IN SELECTED ASIA PACIFIC COUNTRIES
APRIL 2001-MARCH 2002 VS. APRIL 2000-MARCH 2001

(ACTUAL NUMBER)

TO -->	BRUNEI	HONG KONG	INDONESIA	JAPAN	KOREA	MALAYSIA	PHILIPPINES	SINGAPORE	TAIWAN	THAILAND	VIETNAM
FROM											
HONG KONG	17,726		295,760	1,506,602	709,180	437,297	783,380	920,768	3,257,252	1,287,009	195,298
	36.0%		**5.7%**	**-3.9%**	**1.8%**	**-6.6%**	**-8.5%**	**-6.7%**	**-1.7%**	**-5.9%**	**-7.6%**
JAPAN	-	1,313,019	335,973		3,099,186	224,817	461,965	762,149	1,682,577	1,000,934	-
		-6.1%	**-15.0%**		**-1.3%**	**-13.9%**	**3.7%**	**-15.7%**	**-8.9%**	**-0.5%**	
MALAYSIA	66,790	425,960	410,815	293,656	71,116		56,215	1,088,811	178,649	423,366	67,158
	8.6%	**-0.3%**	**9.6%**	**-16.1%**	**1.5%**		**-14.9%**	**-0.4%**	**-16.3%**	**0.8%**	**5.6%**
SINGAPORE	116,217	913,698	1,662,576	821,585	321,123	1,342,986	332,015		322,228	1,164,103	179,479
	-2.5%	**-5.4%**	**15.1%**	**-10.2%**	**-0.1%**	**-6.0%**	**-1.3%**		**14.9%**	**11.9%**	**-1.7%**
TAIWAN	9,172	2,870,917	245,969	1,589,827	193,464	257,007	189,824	308,945		825,174	233,660
	-28.0%	**-8.1%**	**-9.6%**	**-13.5%**	**-4.7%**	**-24.0%**	**81.7%**	**-14.8%**		**-6.4%**	**-18.7%**
THAILAND	34,177	1,184,102	140,018	1,156,093	627,493	413,320	163,857	1,212,837	801,935		294,063
	4.2%	**-9.8%**	**-8.0%**	**-3.5%**	**14.6%**	**4.1%**	**9.1%**	**5.4%**	**-3.5%**		**16.6%**
VIETNAM	-	193,497	-	139,818	136,713	68,558	15,158	176,950	387,841	291,177	
		9.3%		**56.1%**	**29.6%**	**25.5%**	**32.7%**	**10.8%**	**7.5%**	**39.4%**	

Source: Association of Asia Pacific Airlines (AAPA)

AIRPORT SCHEDULED INTERNATIONAL PASSENGER AND CARGO TRAFFIC, BY CITY PAIR (SELECTED ASEAN ROUTES) APRIL 2001-MARCH 2002

	PASSENGER TRAFFIC		CARGO TRAFFIC	
CITY PAIR	**NUMBER**	**% CHG**	**TONNES**	**% CHG**
BKK-BWN	34,177	4.2%	1,817	-19.0%
BWN-BKK	34,197	4.3%	153	34.6%
TOTAL	**68,374**	**4.2%**	**1,970**	**-16.4%**
BKK-JKT	56,755	2.8%	4,121	-5.2%
JKT-BKK	68,146	4.2%	3,661	-10.1%
TOTAL	**124,901**	**3.6%**	**7,782**	**-7.6%**
BKK-KUL	351,433	7.4%	11,400	-17.2%
KUL-BKK	355,645	3.1%	9,662	-21.4%
TOTAL	**707,078**	**5.2%**	**21,062**	**-19.2%**
BKK-SGN	175,781	13.3%	3,807	4.7%
SGN-BKK	186,972	33.3%	2,763	-11.9%
TOTAL	**362,753**	**22.8%**	**6,570**	**-2.9%**
BKK-SIN	1,212,837	5.4%	43,166	-2.6%
SIN-BKK	1,097,418	4.9%	31,798	-16.5%
TOTAL	**2,310,255**	**5.2%**	**74,964**	**-9.0%**
HAN-KUL	18,907	49.5%	5	46.1%
KUL-HAN	18,331	22.7%	135	31.5%
TOTAL	**37,238**	**35.0%**	**140**	**32.0%**
HAN-SIN	37,421	23.6%	454	27.1%
SIN-HAN	39,526	1306.1%	1,433	6238.9%
TOTAL	**76,947**	**132.6%**	**1,887**	**397.1%**
KUL-DPS	68,189	-11.2%	379	97.8%
DPS-KUL	70,275	-12.1%	679	-2.9%
TOTAL	**138,464**	**-11.7%**	**1,058**	**18.7%**
KUL-HDY	4,168	-69.0%	38	174.0%
HDY-KUL	3,591	-76.8%	17	-19.3%
TOTAL	**7,759**	**-73.2%**	**55**	**57.0%**
KUL-JKT	195,262	16.1%	3,067	-12.6%
JKT-KUL	191,777	9.1%	3,013	-33.6%
TOTAL	**387,039**	**12.5%**	**6,080**	**-24.4%**
KUL-SGN	48,827	0.3%	360	-4.8%
SGN-KUL	49,651	18.3%	259	5.4%
TOTAL	**98,478**	**8.6%**	**619**	**-0.8%**
BKK-DPS	83,263	-13.8%	402	-42.4%
DPS-BKK	82,637	-11.1%	3,650	5.6%
TOTAL	**165,900**	**-12.5%**	**4,052**	**-2.5%**
BKK-MNL	163,857	9.1%	5,098	-14.1%

CITY PAIR	PASSENGER TRAFFIC NUMBER	PASSENGER TRAFFIC % CHG	CARGO TRAFFIC TONNES	CARGO TRAFFIC % CHG
MNL-BKK	167,100	8.4%	4,534	-9.6%
TOTAL	**330,957**	**8.7%**	**9,632**	**-12.1%**
BKK-VTE	67,160	-0.5%	651	-4.2%
VTE-BKK	64,754	-5.5%	147	-12.8%
TOTAL	**131,914**	**-3.0%**	**798**	**-5.9%**
HAN-VTE	15,263	18.6%	39	48.7%
VTE-HAN	16,774	1409.8%	0	-89.2%
TOTAL	**32,037**	**129.1%**	**39**	**28.1%**
SGN-PNH	43,613	-7.7%	647	80.2%
PNH-SGN	37,218	570.1%	337	990.8%
TOTAL	**80,831**	**53.1%**	**984**	**152.4%**
SGN-REP	48,308	90.4%	2	-56.5%
REP-SGN	44,403	3843.4%	0	NA
TOTAL	**92,711**	**249.9%**	**2**	**-56.5%**
BKK-PEN	61,887	-11.2%	4,449	11.5%
PEN-BKK	68,233	-6.3%	3,240	-8.5%
TOTAL	**130,120**	**-8.7%**	**7,689**	**2.1%**
BKK-RGN	159,534	-0.7%	4,588	-15.3%
RGN-BKK	163,491	-4.5%	4,090	-24.7%
TOTAL	**323,025**	**-2.6%**	**8,678**	**-20.0%**
KUL-BWN	66,790	8.6%	2,201	-29.3%
BWN-KUL	60,522	7.6%	242	22.6%
TOTAL	**127,312**	**8.1%**	**2,443**	**-26.2%**
KUL-CEB	7,030	-2.6%	57	-7.9%
CEB-KUL	7,282	-0.3%	67	-40.5%
TOTAL	**14,312**	**-1.5%**	**124**	**-28.9%**
KUL-MNL	49,185	-16.4%	2,003	-38.1%
MNL-KUL	50,981	-16.3%	1,013	-37.7%
TOTAL	**100,166**	**-16.3%**	**3,016**	**-38.0%**
KUL-PNH	34,891	-1.3%	356	-16.6%
PNH-KUL	33,514	4.9%	118	-51.4%
TOTAL	**68,405**	**1.6%**	**474**	**-29.3%**
KUL-RGN	13,014	12.2%	196	22.5%
RGN-KUL	15,060	28.3%	108	-23.1%
TOTAL	**28,074**	**20.3%**	**304**	**1.2%**
SGN-SIN	139,529	7.7%	3,896	-5.2%
SIN-SGN	137,010	1092.7%	3,750	800.4%
TOTAL	**276,539**	**96.2%**	**7,646**	**68.9%**

Source: AAPA

CODES:

BKK	Bangkok	HKT	Phuket	PHN	Phnom Penh
BWN	Bandar Seri Begawan	JKT	Jakarta	PEN	Penang
KUL	Kuala Lumpur	REP	Siem Reap	RGN	Yangon
DPS	Denpassar	SIN	Singapore	CEB	Cebu
HAN	Hanoi	MNL	Manila	VTE	Vientiane
HCM	Ho Chi Min	HDY	Hat Yai		

INTERNATIONAL PASSENGER TRAFFIC FLOW BY POINTS SERVED
PHILIPPINES
CY 2002

ITEM NO.	AIRLINE	POINTS SERVED	INCOMING	OUTGOING	TOTAL
1	Air France	Paris	41,880	41,613	83,493
		Bangkok	0	0	0
		Hongkong	0	0	0
		Total	**41,880**	**41,613**	**83,493**
2	Air Macau	Macau	10,326	10,714	21,040
3	Air Nauru	Nauru	0	0	0
		Guam	0	0	0
		Pohnpei	0	0	0
		Total	**0**	**0**	**0**
4	Air Niugini	Port Moresby	5,946	5,493	11,439
5	Asiana Airlines	Seoul	92,160	91,996	184,156
6	British Airways	London	3,099	2,399	5,498
		Hong Kong	1,924	2,181	4,105
		Total	**5,023**	**4,580**	**9,603**
7	Cathay Pacific Airways	Hong Kong	367,250	371,694	738,944
		Hong Kong/Cebu	69,114	69,695	138,809
		Total	**436,364**	**441,389**	**877,753**
8	Canadian Airlines	Canada	operations temp. stopped on Oct. 31, 1999		
		Hong Kong			
		Total	0	0	0
9	China Airlines	HKG (Hkg/Mnt/Hkg)			0
		Taipei	97,691	102,669	200,360
		KHH	22,303	22,330	44,633
		Total	**119,994**	**124,999**	**244,993**
10	Continental Micronesia	Guam	68,877	75,311	144,188

ITEM NO.	AIRLINE	POINTS SERVED	INCOMING	OUTGOING	TOTAL
11	Egyptair	Cairo	1,266	3,313	4,579
		Bangkok	6,879	7,442	14,321
		Tokyo	9,648	11,137	20,785
		Total	**17,793**	**21,892**	**39,685**
12	Emirates Air	Dubai	80,791	90,095	170,886
		Hong Kong	0	0	0
		Total	**80,791**	**90,095**	**170,886**
13	Eva Air	Taipei	69,229	41,671	110,900
14	Gulf Air	Abu Dhabi	22,784	25,921	48,705
		Bahrain	16,163	16,206	32,369
		Doha	9,355	10,949	20,304
		Muscat	9,502	12,750	22,252
		Total	**57,804**	**65,826**	**123,630**
15	Japan Airlines	Narita	196,660	205,042	401,702
16	KLM	Amsterdam	38,882	41,082	79,964
		Bangkok	0	0	0
		Kuala Lumpur	7,756	5,590	13,346
		Total	**46,638**	**46,672**	**93,310**
17	Korean Air	Seoul	120,944	128,439	249,383
18	Kuwait Airways	Kuwait	32,444	37,949	70,393
		Bangkok	7,815	7,570	15,385
		Total	**40,259**	**45,519**	**85,778**
19	Lufthansa	Frankfurt	52,659	54,404	107,063
		Bangkok	26,918	26,742	53,660
		Total	**79,577**	**81,146**	**160,723**
20	Malaysia Airlines	Kuala Lumpur	44,155	43,253	87,408

ITEM NO.	AIRLINE	POINTS SERVED	INCOMING	OUTGOING	TOTAL
		Kuching	1,557	1,599	3,156
		Taipei	0	0	0
		Kota Kinabalu	3,991	4,891	8,882
		Kuala Lumpur/CEB	6,491	4,720	11,211
		Kota Kinabalu/CEB	2,020	1,532	3,552
		Total	**58,214**	**55,995**	**114,209**
21	Northwest Airlines	U.S.A.	150,672	193,352	344,024
		Narita (Tokyo)	48,273	30,771	79,044
		Kansai (Osaka) KIX	146	404	550
		Nagoya	48,167	45,132	93,299
		Total	**247,258**	**269,659**	**516,917**
22	P.T. Bouraq Airlines	Menado/Davao	0	0	0
23	Pakistan Int'l Airlines	Narita	0	0	0
		Karachi	0	0	0
		Total	**0**	**0**	**0**
24	Qantas Airways	Sydney	38,546	40,869	79,415
25	Qatar Airways	Doha	21,927	23,949	45,876
26	Royal Brunei	Brunei	32,151	41,607	73,758
27	Saudi Arabian Airlines	Jeddah	38,228	25,193	63,421
		Riyadh	55,089	69,611	124,700
		Dharan	26,408	19,215	45,623
		Total	**119,725**	**114,019**	**233,744**
28	Silkair	SIN/CEB	25,327	27,298	52,625
		SIN/DVO	6,372	6,147	12,519
		Total	**31,699**	**33,445**	**65,144**
29	Singapore Airlines	Singapore	219,548	229,894	449,442

ITEM NO.	AIRLINE	POINTS SERVED	INCOMING	OUTGOING	TOTAL
30	Swissair	Zurich	12,035	12,767	24,802
		Hong Kong	5,075	5,044	10,119
		Total	**17,110**	**17,811**	**34,921**
31	Thai International Airways	Bangkok	103,581	113,282	216,863
		Osaka	44,696	54,694	99,390
		Total	**148,277**	**167,976**	**316,253**
32	Vietnam Airlines **temp. stopped operations on Oct 01**	Saigon	**code shares with PAL (MNL-HCM)**		
33	China Southern Airlines	Xiamen	30,169	27,587	57,756
		Peking	6,266	7,006	13,272
		Total	**36,435**	**34,593**	**71,028**
34	Aeroflot		**no report**		
35	PAL		1,306,995	1,339,184	2,646,179
36	Cebu Pacific	SIN	3,690	3,616	7,306
		HKG	55,928	64,119	120,047
		Seoul	16,854	14,708	31,562
		Total	**76,472**	**82,443**	**158,915**
37	Air Philippines	LAO-HKG	8,392	8,586	16,978
		GRAND TOTAL	**3,853,014**	**3,982,427**	**7,835,441**

Source: Philippine CAB

PROFILE OF COMPETITION IN SELECTED PHILIPPINE-ASEAN ROUTES (SAMPLE DATA) CY 2002

ROUTES	AIRLINES	INCOMING	OUTGOING	TOTAL	MARKET SHARE	REMARKS
Bangkok –Manila	Egypt Air	6,879	7,442	14,321	3.82%	5th freedom traffic
	Kuwait Airways	7,815	7,570	15,385	4.10%	5th freedom traffic
	Lufthansa	26,918	26,742	53,660	14.32%	5th freedom traffic
	Philippine Airlines	36,493	38,075	74,568	19.90%	Mostly Philippine residents
	Thai International Airways	103,581	113,282	216,863	57.86%	Around 40 percent are Philippine residents, estimated 20% Japanese
	SUBTOTAL	**181,686**	**193,111**	**374,797**		
Begawan-Manila	Royal Brunei	32,151	41,607	73,758	100.00%	Mostly Philippine residents to/from Middle East, Northern Australia
	SUBTOTAL	**32,151**	**41,607**	**73,758**		
Kuala Lumpur –Manila	KLM Royal Dutch Airlines	7,756	5,590	13,346	13.25%	5th freedom traffic (entitlements fully utilized)
	Malaysia Airlines	44,155	43,253	87,408	86.75%	Philippine residents account for around fifty percent of traffic (entitlements to Manila and Cebu fully utilized)
	SUBTOTAL	**51,911**	**48,843**	**100,754**		
Saigon - Manila	Philippine Airlines	18,011	17,880	35,891	100.00%	PAL Code shares with Vietnam Airlines; limited operations (3x per week)
	SUBTOTAL	**18,011**	**17,880**	**35,891**		Connections are via Hong Kong (7 weekly flights from HCM to HKG and 5 daily flights between HKG and MNL)
Singapore -Manila	Cebu Pacific	3,690	3,616	7,306	1.12%	Suspended operations in December 2002
	Philippine Airlines	102,012	96,033	198,045	30.25%	Mostly Philippine residents (traffic also generated from Indonesia)
	Singapore Airlines	219,548	229,894	449,442	68.64%	Passengers carried come from various destinations such as Jakarta, London, Kuala Lumpur
	SUBTOTAL	**325,250**	**329,543**	**654,793**	**100.00%**	

Sources: Philippine CAB, Immigration Data, Airlines

Appendix 9 - Intra-ASEAN Tourist Arrivals

	To Č										
FromĎ	Brunei**	Cambodia**	Indonesia**	Lao PDR*	Malaysia**	Myanmar**	Philippines*	Singapore**	Thailand*	Vietnam*	TOTAL
ASEAN	963,596	58,363	2,114,557	346,968	9,208,136	54,036	133,790	2,519,945	2,614,627	269,448	18,283,466
BRUNEI DARUSSALAM		139	14,526	574	309,529	138	2,136	62,224	13,755	434	403,455
CAMBODIA	115			1531		284	1,054	8,572	79,219	69,538	160,313
INDONESIA	42,157	1,734		1,854	777,449	2,019	15,352	1,364,083	164,994	13,456	2,383,098
LAO PDR	89	1,005			2,391	224	475	1,019	94,052	37,237	136,492
MALAYSIA	831,628	15,994	484,692	3,075		12,532	31,735	576,276	1,296,109	46,086	3,298,127
MYANMAR	419	563		1,276	7,219		1,982	21,674	42,266	1,131	76,530
PHILIPPINES	53,765	2,622	82,828	2,452	122,428	9,939		190,613	142,940	25,306	632,893
SINGAPORE	24,162	10,982	1,477,132	2,239	6,951,594	11,310	57,662	NA	683,296	35,261	9,253,638
THAILAND	10,842	17,496	50,489	326,893	1,018,797	16,936	18,817	260,852		40,999	1,762,121
VIETNAM	419	7,828		7,074	18,729	654	4,577	34,632	97,996		171,909
Others			4,890								4,890

**2002 Figures*
***2001 Figures*
Source: ASEAN Secretariat, National Tourism Organization

Appendix 10 - Brief Description Of The Authors

Monash International Pty Ltd (MI), a wholly owned company of Monash University, provides project management and coordination for Monash’s international development assistance and commercial consulting. As one of the largest university in Australia, with a strong commitment to internationalisation, **Monash University** (Monash) has a dynamic multicultural community with more than 55,000 staff and students.

Professor Peter Forsyth is internationally recognized for his work on air transport. Apart from his work in the economics of aviation, Professor Forsyth is well known for his work on microeconomic reform and regulation and on tourism economics. He is one of Australia’s most published academics on air transport policy. His experience on regulation is recognised by his appointment to the Appeals Panel of the Victorian Government Regulator. In addition to this, Professor Forsyth has consulted for the World Bank on Regional Airline Cooperation in the South Pacific and in PNG on Air Transport Planning, on exploring the link between transport and poverty; and on National Monopoly Regulation in Malaysia and Minor Airports.

Significant Contributions to this Research Field
Professor Forsyth’s work on the economics of aviation and the analysis of microeconomic reform and regulation are of direct relevance to the project. In addition, some of his work on tourism economics, for example, that on international measurement of price competitiveness, is relevant to the project. He has been publishing extensively on the economics of aviation since completing his doctorate. His standing in this field is evidenced in many ways. These include his contributions to international committees, such as the scientific committees of the Air Transport Research Society, the Hamburg Aviation Conference and his membership of the Research Committee of the ATRS Airport Benchmarking Project. He is the Asia Editor of the Journal of Air Transport Management. He has been invited to write review articles for handbooks, and has had several of his papers republished. He has recently edited a volume of classic articles in air transport economics. Over the past few years, he has published several papers on airport regulation, the specific topic of this application. These have set out an approach to handling regulatory problems, and provide critiques of existing regulatory policies. He has been invited to present papers at international conferences and workshops (e.g. the German Aviation Research Seminar, Bremen, 2002) on the topic. The papers written so far form the intellectual basis on which the project will proceed. They have identified the issues, suggested possible solutions, and indicated the areas in which more theoretical and empirical research is needed.

John King is a lawyer and transport specialist with extensive experience in the aviation sector in the Asia Pacific region. He has undertaken a range of assignments with the World Bank and national and regional aviation groups to devise appropriate strategies, cost recovery policies and institutional development solutions. John King provides pivotal industry linkages and considerable experience with air service agreements and other air transport regulation. In Papua New Guinea he provided advice on the strategic implications of air service negotiations and he was responsible for the Aviation component of a World Bank Economic Report on Infrastructure and Operational Needs. He was responsible for pricing strategies for Air Nauru and for a review of aviation policies and planning in Ethiopia, Thailand, Pakistan, Dominica, Georgia, Mongolia, China, Kenya and Royal Tongan Airlines. John King was Director of Air Vanuatu, Polynesian Airlines and has extensive experience of aviation operations, particularly in the Pacific. In Australia and New Zealand he has provided advice in the aviation, tourism and travel industries for a range of public and private sector organizations, including trade associations and airports.

John King’s most recent involvement in liberalisation includes: his participation in the OECD Air Cargo Liberalisation Process (1999-2002); his representation on the Australian

Committee of Pacific Economic Co-operation Council at PECC (2002); his involvement in the South Pacific Aviation Liberalisation Workshop, Noumea; as a representative of the World Tourism Organisation (2003), International Civil Aviation Organisation global Liberalisation Conference, Canada and his presentation of detailed papers for Pacific Asia Travel Association and Australian Tourism Commission on the implication of airline practice, in liberalised environments, for tourism.

Dr. Keith Trace is a transport economist with extensive research and consulting experience. Formerly Assistant Professor in Economics at Monash University, Dr. Trace is currently consulting, specializing in transport economics and policy issues in Australia and the Pacific Rim. His current work involves a major study of non-tariff barriers to trade in transport services for APEC. The APEC project requires detailed country case studies. Dr Trace has recently completed a series of interviews with government officials and transport operators in Canada and the United States, including discussions relating to the liberalization of international and domestic aviation markets (fifth freedom rights, multilateral liberalization, ownership restrictions in domestic aviation markets, etc).

Dr. Trace has undertaken a number of consultancies in the aviation sector. The current study for APEC focuses *inter alia* on current barriers to trade in aviation services as well as progress in liberalising aviation markets. Aviation issues were also prominent in the ADB China 2020 Project, led by Monash International, Dr Trace's role in that project was that of assessing the adequacy of the existing transport network in the Western Provinces of the PRC and advising on priorities for transport investment. In 1998 he also advised a major Australian airline on the economic principles underlying 'economic duplication' of freight services at Sydney International Airport and, in partnership with FDF Consulting, provided advice to the Victorian Department of Infrastructure regarding the development and economic impact of regional airports. An earlier study, undertaken in conjunction with the Centre for Transport Policy Analysis, advised the Western Australian Government on international aviation policy options of benefit to that State.

Maria Cherry Lyn Rodolfo is a Research Fellow in the Transportation and Logistics Center at the University of Asia and the Pacific, Philippines (UAP). She is also Director of the UAP's Tourism Center. Professor Rodolfo has undertaken extensive research and consultancies and published various papers on air transport policy, such as "For Whom Shall We Fly: Challenges to Philippine Aviation," CRC Economic Policy Papers (2000); "Towards Freer Trade in the Skies: A Case Study,"UAP (2001) and most recently "The Air Cargo Sector: Trading at High Altitude," UAP (2002). Ms Rodolfo will provide the Team with extensive local knowledge and experience. She has amassed databases and research in this field and will provide substantial professional research skills in member countries alongside other team members.