Since January 2020 Elsevier has created a COVID-19 resource centre with free information in English and Mandarin on the novel coronavirus COVID-19. The COVID-19 resource centre is hosted on Elsevier Connect, the company's public news and information website.

Elsevier hereby grants permission to make all its COVID-19-related research that is available on the COVID-19 resource centre - including this research content - immediately available in PubMed Central and other publicly funded repositories, such as the WHO COVID database with rights for unrestricted research re-use and analyses in any form or by any means with acknowledgement of the original source. These permissions are granted for free by Elsevier for as long as the COVID-19 resource centre remains active.
Open Skies in ASEAN

Peter Forsyth\textsuperscript{a,}*, John King\textsuperscript{b}, Cherry Lyn Rodolfo\textsuperscript{c}

\textsuperscript{a}Department of Economics, Monash University, Clayton, Vic, 3800, Australia
\textsuperscript{b}Aviation and Tourism Management Pty. Ltd., PO Box 688, Darlinghurst, NSW 1300, Australia
\textsuperscript{c}Department of Economics, University of Asia and the Pacific, The Philippines

Abstract

The countries of Association of South-East Asian Nations (ASEAN) have agreed to the formation of open skies within the region. Member countries differ widely in terms of their GDP per capita, their size, aviation policies and the strength of their aviation industries. Granted these differences, several possibilities for facilitating the move are examined. These include taking an economic approach to aviation negotiations, liberalising within sub-regional groupings, a staged framework of liberalisation, and increasing the scope for low-cost carriers to compete, possibly through development of secondary markets. Moves will also necessitate attention being given to complementary issues, such as competition and subsidy policies and ownership.

\copyright 2005 Elsevier Ltd. All rights reserved.

Keywords: Bilateral regulation; Liberalisation; Open Skies; Low-cost carriers

1. Introduction

The ten member countries of the Association of South-East Asian Nations (ASEAN) have made a policy decision to move to open skies within their region. This move will essentially be a negotiated move, with individual countries agreeing to policy changes which will bring open skies into effect. Examples of negotiated moves to open skies are very rare. The best example of open skies being implemented within a region is in Europe; however, this was not a negotiated move. Rather, open skies was imposed on European Union (EU) member countries by the European Court of Justice. It is very doubtful whether substantial European liberalisation would have come about if it had been up to the individual countries, with their very different policy stances, to negotiate an agreement. Bilateral open skies agreements are common, and there do exist some regional “Open Skies” arrangements; however, these rarely involve anything beyond minimal liberalisation.

The ASEAN countries are very diverse. Some are populous, others are not; some have high per capita incomes, while others are amongst the poorest in the world; some have well-developed aviation sectors, while others have embryonic aviation industries, at best; and some have efficient, financially strong airlines, while others do not. Current aviation policies amongst the ASEAN countries differ, partly reflecting these differences—some pursue very liberal policies, while others have restrictive policies (some of which are not even clearly articulated at present). In this context, achieving the policy goals of open skies will be a considerable challenge.

Achieving a move to open skies poses a range of issues:

- Will ASEAN countries as a whole gain from liberalisation, and more pointedly, will every individual country gain?
- Will the economic gains from liberalisation persuade the more restrictive countries to be less protective?
- Are there any growing forces, such as tourism development and pressure for access to routes from low-cost airlines, which can counteract pressure for the status quo coming from incumbent airlines?
- Will a staged process facilitate liberalisation, by giving incumbents time to adjust, and by demonstrating the potential benefits of liberalisation?
- Are there some sub-regions that can liberalise faster than the ASEAN region as a whole? and
Are there other changes, such as in competition policy and towards state subsidies, which would enable a move to open skies to work more effectively?

2. Background

2.1. ASEAN moves towards Open Skies

The ASEAN was established on August 8, 1967 by Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei later joined in 1984 followed by Vietnam (1995), Laos and Myanmar (1997) and lastly Cambodia (1999). ASEAN was formed to accelerate economic growth, social progress and cultural development in the region, and promote regional peace and stability. Reforms are implemented based on consensus by all members—unlike in Europe, where many decisions are imposed on countries by supranational bodies like the European Commission, the Council of Ministers and Courts.

The move towards Open Sky (as open skies is called in ASEAN) is embodied in a number of ASEAN declarations. In 1995 the ASEAN Leaders adopted the Agenda for Greater Economic Integration\(^1\) in Bangkok which included the development of an Open Sky Policy as an area of cooperation in the Plan of Action for Transport and Communications (1994–1996). The ASEAN Vision 2020 prepared in 1997 aimed at forging closer economic integration within the region.\(^2\) Furthermore, the Successor Plan of Action in Transport 1999–2004 identified enhanced regulatory and competition policy options for the ASEAN civil aviation sector as one of its strategic thrusts (ASEAN, 1999). It aimed to promote a more competitive environment for air transport services and operations, by way of liberalisation initiatives and agreements that may be a gradual step towards an Open Sky Policy in ASEAN. Specifically, it called for the following: (a) development of the liberalisation policy for air freight services; and (b) adoption of more liberal and flexible air services arrangements, initially in the ASEAN sub-regional groupings like Brunei–Indonesia–Malaysia–Philippines East ASEAN Growth Area (BIMP-EAGA), and the Cambodia–Laos–Myanmar–Vietnam group (CLMV). In 2001, the ASEAN Transport Ministers at the 7th Air Transport Meeting (ATM) agreed to launch a regional initiative for the progressive and phased liberalisation 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 liberalisation of air freight services in ASEAN.

During the past 3 years, the ASEAN Air Transport Working Group (ATWG) developed the “Roadmap for the Integration of ASEAN: Competitive Air Services Policy”—the liberalisation steps and indicative implementation timeframes—which was endorsed by the 9th ATM in Myanmar in October 2003. Following on 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 co-operation plan for 2005–2010 for the adoption of the 10th ATM. A special meeting on ASEAN Open Sky held in Ho Chi Minh City in February 2004 produced a draft outline for the ASEAN Action Plan and approved during the 9th ATWG Meeting in Manila in March 2004. This outline drew on a Report to the ASEAN Secretariat to which the present authors contributed (Monash International, 2004).

ASEAN Open Sky involves internal regional liberalisation. It does not involve liberalisation of routes between ASEAN members and non-member countries. This is an important issue which remains to be handled on a bilateral basis, and which is not discussed here.

2.2. Aviation in ASEAN

As a region, ASEAN boasts of a population of over 500 million and a combined gross domestic product of over $700 billion. Diversity characterises the levels of growth and development of its members (see Table 1). This diversity has several implications for the aviation industry and for aviation policy. For discussion of ASEAN air transport, see Bowen (1997); Findlay and Forsyth (1990); Findlay and Forsyth (1992); International Civil Aviation Organisation (2001); Li (1998); Oum (1997) and Oum and Yu (2000).

Aviation markets remain limited in countries such as Laos and Cambodia with per capita incomes of $417 and $311, respectively. While Brunei and Singapore have small population bases, their high per capita incomes make their citizens (especially for Singapore) a large source for intra-ASEAN travel. Large domestic aviation markets (actual or potential) characterise middle-income states, namely Indonesia (population of 218 million), Philippines (83 million), Vietnam (82 million) and Malaysia (25 million). In general, domestic markets in most ASEAN countries remain undeveloped with air routes operating with low traffic densities, low frequencies and small and relatively high cost aircraft. Thus there is a tendency for overall average cost to be higher than on busier air routes. Some data on travel patterns are given in Table 2.

The diversities are likewise evident and reflected in the state of airline capabilities, aviation policies, attitudes to liberalisation and airport infrastructure. National carriers play significant role in the aviation industries of most ASEAN countries as they operate domestic (except for Singapore and Brunei), intra-ASEAN and extensive

---

1 Included the acceleration of the timetable for the realisation of AFTA (ASEAN Free Trade Area) from the original 15-year timeframe to 10 years.

2 The Hanoi Plan of Action, adopted in 1998, serves as the first in a series of plans of action leading up to the realisation of the ASEAN vision.
networks linking Asian ports to Europe, Middle East, North America and Australasia. Hit by a series of crises, ASEAN carriers are struggling to recover huge financial losses and develop more efficient route networks.

Singapore’s national carrier, Singapore Airlines (SIA) is the largest ASEAN airline and one of the 20 largest in the world. Other aviation tigers like Malaysia and Thailand also boast of relatively large fleets of aircraft and extensive networks. On the other hand, countries like Laos, Myanmar and Cambodia have relatively few bilateral ASAs, undeveloped aviation policies and airlines with limited capabilities in terms of aircraft and choice of aircraft, marketing, supporting network, alliance participation and in achieving reliability of operations. They also face managerial and skilled labour shortages.

The disparity in capabilities is likewise highlighted by the degree of government support granted to ASEAN airlines. Except in Philippines and Cambodia, most ASEAN airlines are either wholly owned or majority owned by government. SIA is majority owned (56.83%) by the Singapore Government, operating through Temasek Holdings. Thai Airways is also majority (92%) owned by government, although there are longstanding plans to privatise more of the company. 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. 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.

ASEAN countries differ in their policy regarding ownership and control. 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 favours more liberal rules, and would like to move to a ‘principal place of business’ criterion, although

---

3 Asian financial crisis (1998), 9/11 terrorist attacks in the US (2001), outbreak of Severe Acute Respiratory Syndrome (SARS) and Iraq War (2003).
the Singapore Government recognises that this would pose problems given that many of its ASAs specify ‘substantial ownership and control’ (as is the case with the rest of ASEAN).

Low-cost carriers (LCCs) have had a major impact on airline competition in the US, Europe, and in other areas, and they have now begun to have a major impact in the ASEAN region. The deregulation of the domestic markets paved way for the birth of LCCs which have also opened up of new ASEAN routes. The best-known carrier is Air Asia, although Cebu Pacific in the Philippines was established as early as 1997 and operated domestic routes. Other start-ups include Thai Air Asia, One-Two-Go and Nok Air in Thailand, ValuAir, Jetstar Asia and Tiger Airways in Singapore and Lion Airlines in Indonesia. At present, the scope for LCCs to operate in ASEAN is limited: they can operate only in deregulated domestic markets and on specific liberalised international routes. Many LCCs in the region have found that their growth has been stymied by their inability to gain access to regulated international routes.

2.3. Aviation policies

The objectives of aviation policy differ across countries but also 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 like Singapore and Thailand have clear policy objectives and well-developed policies for the aviation sector. In less-developed ASEAN countries like Myanmar, Laos and Cambodia, aviation policies are not specified in detail and each situation tends to be approached on a case-by-case basis, thereby giving rise to flexibility but also uncertainty.

Not surprisingly, the enthusiasm for liberalising aviation markets varies across ASEAN. Singapore has traditionally adopted liberal aviation policies in developing an airline hub and with SIA attracting substantial 6th freedom traffic coming to/from ASEAN. To support tourism, Malaysia has poised the Kuala Lumpur International Airport (KLIA) to compete with Singapore, thereby granting liberal traffic rights to carriers of countries offering reciprocal rights, and incentives to new entrants operating in KLIA. The attitudes toward liberalisation in ASEAN are also influenced by the relative importance of intra-ASEAN tourism as well. For the Philippines ASEAN inflows have historically accounted for only 6 percent of the total visitor arrivals. Thus, there is greater enthusiasm in opening up the Northeast Asian markets of Japan and China than in ASEAN.

ASEAN countries remain heavily reliant on bilateral ASAs, although some have joined regional and multilateral arrangements. The CLMV multilateral agreement provides for unlimited capacity and unlimited traffic rights, including 5th freedom rights across member countries. Sub-regional arrangements like BIMP-EAGA and the Indonesia–Malaysia–Thailand Growth Triangle (IMT-GT) grant very limited open skies agreements. Fifth freedom rights to have been extensively granted to non-ASEAN countries by ASEAN members like Thailand, in line with its development of Bangkok as a regional hub.

Multiple designation is already being adopted in most ASEAN countries following deregulation of the domestic industries. 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.

In spite of the liberalisation initiatives of most ASEAN countries, capacity remains restricted on a number of routes because there are no existing ASAs, and/or the agreements are already dated. Laos, for example, has no agreement with ASEAN partners like Indonesia, Brunei or Philippines. There are also cases where one country, like Indonesia favours opening up more of its gateways to ASEAN than non-ASEAN partners. Cases exist where one country (e.g. Malaysia) has high or full utilisation already of its air traffic rights (to the Philippines) by the incumbent carrier but the bilateral partner does not prioritise any renegotiations; this prevents new entrants from developing the market. In some cases, charter operations are used to circumvent the restrictions imposed by the ASAs, particularly during peak periods. Incumbents, on the other hand, engage in co-operative agreements, such as code shares, with the carrier of the country that is not operating its full capacity.

In general, there are permissive policies regarding various co-operative arrangements and alliances. Singapore Airlines and Thai Airways are members of the Star Alliance. Malaysia Airways and Garuda operate 3rd country code sharing services and Myanmar, Philippines and Vietnam also permit code sharing. It has been noted that charters are not frequently used at present and the approval process is not necessarily speedy in some countries. In terms of air freight, ASEAN countries have adopted a relatively liberal attitude with member states endorsing the ASEAN MOU on Air Freight Services, the first step towards the full liberalisation of air freight services in the ASEAN region. However, Singapore, Brunei and Thailand went ahead of the rest of ASEAN by signing an agreement in February 2004.

In summary, the diversities across ASEAN economies leads to conflicting views about liberalisation, making it difficult to achieve; however, it also means that the scope for gain from a more efficient internal aviation sector is substantial.

---

4The 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.
3. Open Skies: rationales and impediments

3.1. Rationales for Open Skies

Open Skies in ASEAN consists of liberalisation of the aviation routes between ASEAN member countries. It will involve removal of capacity controls on routes, removal of entry barriers, and freeing up ownership arrangements. These can be expected to lead to efficiency gains in the ASEAN air transport industry, leading to net overall gains in economic welfare.

The gains from liberalisation will come about from two sources—gains from trade, and gains from more competitive markets.

Gains from trade in airline services come about when liberalisation leads to airlines best suited to particular routes gaining an increased market share on those routes. As a result, the overall cost of serving these routes falls, and product quality increases. Under regulation, a high-cost airline will be guaranteed a market share—under liberalisation, a lower cost airline from a partner country will gain market share.

Gains from competition come about when there is stronger competition between incumbents (which are no longer limited by regulation in the market share they can attain) and from new entrants. Initially, competition puts pressure on prices, and consumers gain at the expense of airlines and aviation producers. In the short run, costs may not fall, and airlines lose out. In the long run, costs can be reduced to levels sufficient to ensure profitability—if they cannot, exit of airlines will result in fares rising, though not to original levels. In practice the competitive process is much less ordered than this suggests, and airline industries experience long periods of poor and good profitability.

Competition also stimulates the introduction of new products and the serving of market segments which were not well served before. Thus the LCCs have stimulated demand from new market segments which the full service carriers (FSCs) did not serve well before. The European experience suggests that new entrant LCCs play an important part in the competitive process—immediately after liberalisation, competition between the FSCs did not increase sharply, and the benefits from liberalisation were modest (Civil Aviation Authority, 1998). It was the entry of LCCs which really made a difference to the European market (Doganis, 2001; Lawton, 2002; Williams, 2002).

The main gains and losses will be experienced by the consumers and producers of air transport. However, tourism industries will also be affected by airline liberalisation. Lower fares mean more travel, and more business for tourism industries. While overall tourism will gain (especially as tourism in ASEAN becomes more competitive relative to other regions), it is possible that tourism industries in some countries will lose out, if domestic tourists substitute international for domestic tourism.

The size of the likely gains from liberalisation is an empirical question. Systematic evaluation is difficult, given the lack of data. However, such evidence as does exist points to significant gains. There appears to be a wide divergence in the productivity and cost efficiency of ASEAN airlines (see Tables 3 and 4). Some ASEAN airlines are extremely cost competitive by world standards and these have been successful in international markets (Oum and Yu, 1998a, b) (see Tables 3 and 4). Other airlines appear to be much less cost competitive, and less financially successful. There is evidence of wide dispersion of air fares. Fares on tightly regulated routes are higher than on the more competitive routes. There are considerable directional imbalances in fares on some controlled routes—this suggests that not all fares are closely based on costs. A further piece of evidence comes from the fares now being offered on domestic routes by LCCs. These are significantly lower than on international intra-ASEAN routes of similar distance and density. Overall, while systematic studies of fares and productivity are yet to be done, the evidence which is available strongly suggests the possibility of strong gains from liberalisation.

Overall, the pattern of gains and losses is likely to be as follows. Consumers or passengers will be the main beneficiary of liberalisation, gaining from lower fares and a better range of services. Airline industries will lose, though less than consumers gain, in the short run. Airline industries are not likely to lose out in the long run, when costs have had time to adjust. Tourism industries will gain. However, it is likely that the gains to a country from additional tourism will be of a smaller order of magnitude than the consumer benefits. There will be an overall welfare gain. However, not all of this gain need accrue to ASEAN countries as a whole, or to individual ASEAN countries.

It is very probable that ASEAN countries as a whole will gain in the short and long run. To the extent that the consumers of airline services are from ASEAN, the benefits to ASEAN residents is likely to exceed any losses in the short run to ASEAN owned airlines. ASEAN tourism industries will gain from more travel within ASEAN.
long run, the airline industry will not be worse off as a result of Open Skies.

For individual countries, the extent to which they gain from Open Skies depends on the use to which they make use of air transport, and the reliance of their tourism industries on air. Countries which generate tourism, such as Singapore, will gain. Those countries which are not in a position to generate much air travel, because their per capita incomes are low, will not gain much by way of consumer benefits. If they have tourism industries, lower air fares will stimulate these, and provide a source of gain. It is improbable that any country will be a net loser from Open Skies—for this to be the case, losses at the airline level would have to outweigh the gains at the consumer and tourism levels. Countries which do not generate much air travel do not tend to have high cost but highly profitable airlines which would lose out from liberalisation.

3.2. Impediments to Open Skies

For countries which have well-established aviation industries, producer interests can be an impediment to change. Airlines which face more competition may face a loss of market share, and which face pressure on costs, will oppose liberalisation. The workforce of these airlines will also oppose change, since they may lose jobs and wages will be put under pressure. As in other countries and regions, there are airlines in ASEAN countries which are hostile to liberalisation.

The picture is mixed however. Some ASEAN airlines are publicly in favour of liberalisation. These tend to be the airlines which are successful financially, have high productivity, and which see opportunities if they are permitted to serve new markets, or existing markets on a less restrictive basis. In contrast to these, some established airlines oppose liberalisation. These tend to be airlines which have been less successful. Such airlines have high public profiles, and they have strong connections to their governments. The emergence of LCCs in the ASEAN region is making them even more wary—they have observed the difficulties which FSCs in Europe and elsewhere are having competing with LCCs. These airlines are strong supporters of the status quo, with a preference for routes which are capacity controlled and reserved for incumbent airlines. Governments, partly reflecting pressure from airlines, but also reflecting their own inclinations, are often protective. They seek to preserve national airlines as entities, and seek to encourage the aviation sector within their borders. They are thus concerned about the possibility of their airlines and aviation sectors losing out to stronger airlines from other countries.

The situation is rather different in countries which do not have established aviation sectors. There are several countries in ASEAN which do not have large, experienced airlines. Their airlines are small, by regional standards, have few profitable routes, and are financially vulnerable. They have limited access to finance, and their fleets are not modern or efficient. These airlines are concerned about their ability to survive in a more competitive environment. They are worried about larger incumbent airlines and LCCs alike. In some cases they and their governments may believe that they can grow into competitive airlines, but that if liberalisation is too rapid, they may not get an opportunity to develop. For these airlines, there is a traditional infant industry issue—an industry which cannot compete now may be able to compete later if it is given an opportunity to develop. Governments of countries which have these airlines are also concerned that if their airlines fail, their air services will be reduced. Airlines and governments in this situation will oppose rapid liberalisation, though they may be willing to agree to gradual liberalisation if it is accompanied by measures which strengthen their airline industries.

A natural counterpart to airline or producer interests is the tourism industry. Tourism industries do well when air fares are low, and travel is stimulated. Many ASEAN countries have extensive and well-developed tourism industries. However, as is the case in other countries, the tourism industry does not appear to have the same influence over government policy as does the airline industry. This can be explained by the diverse nature of the industry, and the predominance of small firms. Tourism interests are much less able to lobby governments than are airline interests. In some ASEAN countries, a distinct voice of the tourism industry is emerging, though it has yet to gain much influence.

3.3. A timetable for reform

In the report provided to the ASEAN Secretariat (Monash International, 2004), a possible timetable for the move to Open Skies was suggested. This involved three distinct stages, resulting in a gradual move to extensive liberalisation. The phases and their main components are as follows:

**Phase 1** (1:2005-12:2007): double disapproval of fares; double designation; unlimited 3rd and 4th freedom

---

Table 4
ASEAN airlines cost and efficiency differences, as compared to American Airlines, 1993

|              | Unit cost difference | Input price difference | Efficiency difference | Cost competitiveness difference |
|--------------|----------------------|------------------------|-----------------------|-------------------------------|
| Singapore Airlines | -30.6                | -20.3                  | 3.9                   | -16.3                         |
| Thai         | -20.8                | -52.1                  | 42.9                  | -9.3                          |

Source: Oum and Yu (1998b).
capacity; a move to substantial ASEAN ownership of a country’s airline permitted; access to secondary gateways (target).

**Phase 2** (1.2008-12:2010): no fare controls; multiple designation; access to secondary gateways; open passenger charters.

**Phase 3** (1.2011-12.2012): principal place of business ownership test; unrestricted 5th freedom for ASEAN carriers within ASEAN.

Alongside these changes, there would be scope for faster change on a sub-regional basis. One sub-region, involving Cambodia, Laos, Myanmar and Vietnam, (CLMV) has already been formed. Others may form, for example, involving the nations with more advanced aviation sectors such as Singapore, Malaysia and Thailand. More extensive liberalisation between like countries with airlines of comparable strength may be relatively easy to achieve. This suggested timetable was developed with regard to a number of factors. It would achieve full Open Skies a couple of years before 2015, the target set for Open Sky.

Benefits from liberalisation would begin in the first phase, though the aviation industries in each of the countries would have time to adjust. In the first phase, there would be more competition on major routes, and the removal of capacity controls, along with the opening up of secondary gateways, would enable new airlines (possibly existing domestic airlines) to develop. Entry of new airlines, such as LCCs, on the secondary gateways would assist tourism destinations to develop, as they have in Europe, and would provide a demonstration of the benefits of opening up markets. Incumbent carriers would face more competition, though they would have until the second phase before this competition became substantially deregulated. Countries with relatively undeveloped aviation industries would not be exposed to full competition initially. Over time, ownership would be liberalised, enabling airlines from the nations with relatively developed aviation to invest in and assist the development of airlines in countries with relatively undeveloped aviation.

### 4. Facilitating liberalisation

#### 4.1. Sub-regional approaches and parallel liberalisation

There are currently, in ASEAN, a number of sub-regional approaches to policy change across a variety of sectors. One of those, BIMP-EAGA, makes a limited provision for facilitation of low-level aviation linkages but is seemingly little used. The CLMV agreement, on the other hand, is exclusively an aviation agreement between the subscribing parties (CLMV). The IMT-GT agreement also allows for airline co-operation between secondary and tertiary points, however again there has been little use of this sub-regional agreement between Indonesia, Malaysia and Thailand.

It is possible, however, within ASEAN, to consider the formation of new sub-regional blocs which involve national level co-operation rather than co-operation associated merely with secondary and tertiary points. Over an agreed time scale, these sub-regional blocs can be integrated, and while this process of sub-regional integration is occurring, there can occur significant policy liberalisation, i.e. there can be simultaneous movement on both a policy and geographic basis. As policy changes occur on a sub-regional basis, other sub-regions can observe what is occurring and see the benefits of change and phase it in within their own sub-region(s). A particular sub-region may be more advanced in liberalisation than others and as mergers occur, liberalisation will spread. Of course, at the same time, liberalisation should continue on a bilateral basis, as many bilateral agreements will remain in place.

The disparities in the economies, the markets and the aviation capacities mean that progress to an ‘Open Sky’ cannot be achieved in one step; hence, the proposal for simultaneous policy initiatives and geographically related sub-regions. Some countries may participate in more than one sub-region and of course, as the sub-regions merge, there will be multiple participation across the regions, until, eventually, the entire sub-regions merge to form the one ASEAN Open Sky. The sub-regions can be based on a similarity of economic and aviation strength, but even within a sub-region there may be disparities. In CLMV, Cambodia, Laos and Myanmar are more similar to each other than any of them is to Vietnam in terms of economic and aviation power. They came together, however, in the CLMV agreement because of perceived benefits and because of perceptions of the economic and aviation strengths of neighbours: there was a perception of a community of interest.

The second sub-region proposed was Vietnam, Indonesia, Philippines plus Brunei (VIP+B). Philippines and Vietnam already have a type of open skies agreement and the three constitute broadly similar aviation economies, though Indonesia because of its archipelago nature and physical size has a larger domestic aviation sector. The 3rd sub-region is to be SMT & B: Singapore, Malaysia and Thailand, with the addition of Brunei. The first three represent the “tigers” of ASEAN aviation. They each have a large aviation sector with each having major international airlines operating to many countries. Each of these three have very open 3rd and 4th freedom capacity regimes with each other and thus it would be simple to constitute a third sub-region.

#### 4.2. Opening secondary markets

Whilst LCCs have an important role to play in the opening of secondary markets in that they have a lower cost of entry than FSCs, they are not the only participants in secondary markets. Many full service and hybrid carriers operate in these markets. Singapore, as an example, has long had two airlines: Singapore Airlines and Silk Air, the former operating wide body equipment on long haul and/or dense routes, whilst Silk Air (owned by Singapore
Airlines) operates exclusively narrow-bodied equipment on short haul and thin routes. Silk Air is a FSC offering, within the confines of its stage lengths and aircraft types, a conventional 2 class (generally) short-haul airline product.

Silk Air links secondary markets to the Singapore hub. In both Indonesia and Thailand there are secondary airlines serving secondary markets, some are endeavouring to re-invent themselves as “LCCs”. The rise of the secondary carrier, whether LCC or not, has been beneficial to the opening of important tourism destinations such as Mandalay (Myanmar), Siem Reap (Cambodia), Luang Prabang (Laos) and Danang (Vietnam) all of which are served by secondary carriers.

Unless countries have an open capacity and route regime under which any designated carrier from one country can fly to any point in the other country without any restriction of capacity, then it can be difficult to develop secondary routes. Sometimes there is discrete capacity allocated for secondary routes which can only be used on those routes but there are also situations where dominant carriers control all the capacity and use it exclusively on prime city pairs thus denying or at least restricting growth opportunities for secondary destinations.

4.3. Role of low-cost carriers

Open Sky will provide fertile conditions within which LCCs can develop in the ASEAN region. LCCs have expanded consumer choices and improved the efficiencies of airline industries. They have also forced regulators to change old rules of the game that tended to protect FSCs and their key markets. It is likely that an Open Sky environment in ASEAN that removes restrictions on designation, capacity and fares will support the growth and development of the LCCs. On the other hand, the rise of more LCCs in the region will exert pressure for the acceleration of the ASEAN Open Sky.

At present, LCCs are operating to a limited extent in the ASEAN region, often in domestic markets only—because of restrictions imposed by existing bilateral ASAs in terms of designation, capacity and fares. Their success in the domestic markets have exhibited demonstration effects such that consumers are seeking to enjoy the same benefits of more services and better fares in the regional markets. They are operating in secondary markets or gateways, developing new routes and providing indirect competition to incumbent carriers.\(^5\) 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. However, even this indirect competition is forcing incumbent FSCs to review their productivity and cost competitiveness to address their low productivity labour arrangements and inability to respond to market changes. Some FSCs have responded to new competition by setting up their own low-cost subsidiaries (e.g. SIA has a 49% stake in Tiger Airways).

The rapid development of LCCs in Singapore, Indonesia, Malaysia, Thailand is now resulting in pressure on regulators for access to more international routes. Having exhausted domestic opportunities, the LCCs are seeking to operate on international routes throughout the region, as well as on routes beyond the region. ASEAN internal routes, with short to medium hauls and low to moderate density are very suited to the LCCs. Many ASEAN routes are blocked to new entrants, and this is constraining the growth of the LCCs. These LCCs are seeking multiple designation, pursuing more liberal traffic rights and greater transparency in the allocation of traffic rights. These LCCs are likewise forcing regulators to accelerate the development of competition policies that will support their growth and development, provide a framework to address issues like predation by FSCs and more importantly, expand the gains from liberalisation. These pressures will tend to drive ASEAN to accelerate its liberalisation process.

4.4. Ownership and investment

Bilateral and multilateral air service agreements have traditionally embodied a requirement that an airline be substantially owned and effectively controlled by the state of designation. It is also entrenched in many national laws. Compared to a principal place of business test, this greatly constrains foreign investment and regional co-operation.

Lelieur (2003, p. 119) argues that regionalism is a first step to the liberalisation of ownership and control in that the traditional concerns about ownership liberalisation (traffic rights and national and economic security) are not as relevant when the (sub)-regional parties are equal. Cross-border investment between more than two states requires a regional approach, however it is a process, which outside of the EU, has not proceeded well. The CLMV agreement retains very conventional ‘ownership and control’ clauses which is surprising because of the CLMV sub-regional partners have extensive foreign investment in their airlines. Myanmar from within ASEAN and Cambodia from within ASEAN and importantly, Hong Kong, as well.

If more extensive investment in the aviation sectors of the ASEAN countries is to occur, the sub-regional agreements as well as the continuing bilateral agreements should be varied from the traditional ‘ownership and control’ model, to a ‘principal place of business’ model.

5. Complementary reforms

5.1. Competition policy

Airline liberalisation has normally taken place in countries or regions with extensive competition policies,
such as Europe, North America, Australia and New Zealand. ASEAN liberalisation is to take place in an environment of very limited competition policy. Some countries such as Singapore and Malaysia have the development of competition policies underway, but others do not possess explicit competition policies. In some cases, the pressure for competition policies in ASEAN is coming from external forces, such as trade agreements concluded with other countries. The lack of competition policy could influence how Open Skies work in ASEAN.

Several aspects of competition policy are potentially relevant. These include mergers, collusion and price fixing, and predatory behaviour.

Controls on mergers exist to prevent the dominance of a market by one or a few firms, and to prevent the elimination of competition. Merger policy is often applied to airlines. In the US, airline mergers have been permitted after investigation, but it is unlikely that the large carriers, such as United or American, would be permitted to merge with each other. In Europe, the merger between two large airlines, KLM and Air France, has been permitted—competition from other airlines was judged sufficient to eliminate the possibility of dominance. It is possible that mergers between major carriers in ASEAN (assuming relaxation of current ownership restrictions) would lead to dominance by a few airlines. Cross-country mergers are, however, difficult to achieve efficiently (though alliances are not), and this would lessen the urge to merge. If competition from LCCs is strong, the consequences of mergers by major airlines would be less severe.

Collusion in pricing has been permitted in airline markets, though it is being increasingly outlawed. The objective of Open Skies is to promote competition, and collusion would thwart this objective. Within countries, price-fixing cases involving airlines are not common, though they are for other industries, such as freight and construction. The higher profile of airlines may make collusion more difficult to hide. Price fixing between airlines could be a real problem in a liberalised environment in ASEAN.

Of all competition policy issues, predation has been a big one for airlines, especially where small entrants have been challenging large incumbents. There have been many cases or allegations of predation in the US, Europe, Canada and Australia involving airlines (see Forsyth et al., 2005). Few of these have been proven however. Some cases (the Lufthansa–Germania case) have been concluded and remedies instituted. Incumbent airlines have strong advantages, but entrants also have some advantages, such as flexibility and lower costs. Even though cases are rarely proven, the law may be restraining predation. Predation is likely to be an issue in the ASEAN context, where incumbent airlines are being challenged by small new entrants.

5.2. Guidelines for state assistance

One concern raised by private carriers in the move to ASEAN Open Sky is the uneven playing field because national carriers do not compete on equal terms. The incumbents are either fully owned or majority owned by government and being subsidised for decades. These subsidies take various forms such as direct financial assistance, favoured access to government business, bankruptcy provisions, and monopoly privileges which allow cross-subsidisation of airline operations. They can therefore engage in price wars, weed out competitors and increase market shares. Subsidies distort the competitive process and based on the experience of ASEAN airlines, can breed inefficiencies, lead to higher costs and fares and make airlines survive competition only through extensive protection.

How can ASEAN therefore pursue Open Sky given the various degrees of subsidies granted across airlines? The question therefore, 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. ASEAN is not the only authority confronting the issue of state subsidies particularly in developmental or rural routes but there is a lack of transparency on how those subsidies are granted (e.g. absence of competitive bidding as practised in several countries) across ASEAN countries.

ASEAN can likewise learn from the experience of the EU where the problem of state aid is taken very seriously and where national carriers have been extensively subsidised in the past. There is a general policy that 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. Transparency in the granting of subsidies is required and requests can likewise be rejected.

6. Conclusions

ASEAN countries have adopted a policy of moving to open skies. This is something which has not been achieved, in substantial terms, by other regional groupings, except in the case of Europe, where special circumstances prevailed. The move takes place in a region of considerable diversity—in real incomes, in the size of aviation and tourism sectors, in airline cost competitiveness, and in air transport policies. As against this, there is evidence that open skies within ASEAN would bring considerable benefits to the region as a whole, though these gains might not be equally shared by all countries.

There are no simple ways in which the move to open skies can be achieved. Staged, rather than rapid, liberalisation is more likely to be accepted, as it will give incumbent airlines and institutions time to adjust. Sub-regional groupings may be able to move faster than ASEAN as a whole. Pressure from rapidly developing LCCs may assist in breaking down restrictions, and it could lead to liberalisation ahead of the proposed schedule. Opening up secondary markets is giving LCCs scope to expand, and demonstrate the potential gains from more extensive liberalisation. The process will be helped if
countries move away from the legalistic approach to aviation negotiations, emphasising rigid reciprocity and non-interchangeability of aviation and non-aviation trades, to one which assesses the benefits and costs of liberalisation to countries, and which seeks to promote the country’s overall economic interests. Finally, the institutional and policy environment in which the move takes place will have a significant impact on its success—open skies will work better if competition policy, subsidy, and ownership issues are explicitly addressed.

References

Association of Southeast Asian Nations, 1999. ASEAN Transport Cooperation Framework Plan. ASEAN Secretariat, Jakarta.
Bowen, J., 1997. The Asia Pacific Airline Industry: Prospects for Multilateral Liberalization. In: Findlay, C., Chia Lin, S., Singh, K (Eds.), 1997. Asia Pacific Air Transport: Challenges and Policy Reforms. Institute of South East Asian Studies, Singapore.
Civil Aviation Authority (UK), 1998. The Single European Aviation Market: The First Five Years. CAA, London CAP 685.
Doganis, R., 2001. The Airline Business in The 21st Century. Routledge, London.
Findlay, C., Forsyth, P., 1990. ASEAN Interests in Air Transport Services in the Uruguay Round. in: UNCTAD/UNDP, Services in Asia and the Pacific: Selected Papers, vol. 1. United Nations, New York.
Findlay, C., Forsyth, P., 1992. Air Transport in the Asian Pacific Region. Asia Pacific Economic Literature 6, 1–10.
Forsyth, P., Gillen, D., Mayer, O., Niemeier, H.-M. (Eds.), 2005. Competition Versus Predation in Airline Markets: A Survey of North America, Europe and Australia. Ashgate, Aldershot.
International Civil Aviation Organisation, 2001. Regional Workshop on Air Transport Policy, Bangkok.
Lawton, T., 2002. Cleared for Take-Off: Structure and Strategy in the Low Fare Airline Business. Ashgate, Aldershot.
Lelieur, I., 2003. Law and Policy of Substantial Ownership and Effective Control of Airlines: Prospects for Change. Ashgate, Aldershot.
Li, M., 1998. Air Transport in ASEAN: Recent Developments and Implications. Journal of Air Transport Management 4, 135–144.
Monash International, 2004. Preparing ASEAN for Open Sky. Report to the ASEAN Secretariat, Regional Economic Policy Support Facility.
Oum, T.H., 1997. Challenges and opportunities for Asian airlines and governments. In: Findlay, C., Sien, C.L., Singh, K. (Eds.), Asia Pacific Air Transport: Challenges and Policy Reforms. Institute for South East Asian Studies, Singapore.
Oum, T.H., Yu, C., 1998a. Cost competitiveness of the World’s Major Airlines: an international comparison. Transportation Research A 2, 407–422.
Oum, T.H., Yu, C., 1998b. Winning Airlines: Productivity and Cost Competitiveness of the World’s Major Airlines. Kluwer, Boston, Dordrecht and London.
Oum, T.H., Yu, C., 2000. Shaping Air Transport in Asia Pacific. Ashgate, Aldershot.
Williams, G., 2002. Airline Competition: Deregulation’s Mixed Legacy. Ashgate, Aldershot.