

**REGIONAL OPEN SKIES REGIME IN SOUTHEAST ASIA AND ITS
RELEVANCE TO AIR TRANSPORT DEREGULATION IN INDONESIA**

Rizkia Amelia Sania Putri

**Institute of Air and Space Law
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ABSTRACT

Southeast Asia, a subset of the Asia-Pacific region, is the home of a rapidly growing aviation market. For the ten Member States of the Association of South-East Asian Nations (ASEAN), stronger cross-border integration in the aviation sector is important to support the ASEAN Economic Community (AEC) agenda and to respond to the impacts of global liberalization in air transport. In this regard, a set of open skies agreements and implementing protocols have been concluded and ratified by the ASEAN Members.

Although ASEAN has achieved substantial progress in the regional liberalization of air transport, the realization of single aviation market seems to be far-fetched. Some stumbling blocks to achieve a greater liberalization are the limiting traffic rights and restrictive ownership and control requirements as stipulated in the agreements. Moreover, the disparate domestic aviation policy of its Members has been a formidable hindrance to implement the agreements.

The purpose of this study is two-fold. First, it critically analyzes some key provisions laid down in the ASEAN open skies agreements in relation to the establishment of a single aviation market. Second, this thesis attempts to shed light on Indonesia's stance toward ASEAN open skies policy. Within this purview, this thesis will examine the progress of open skies regime in ASEAN and how this regional regime and the national aviation policy of Indonesia should be mutually reinforcing.

This thesis concludes that the lengthy process for ASEAN Members to fully implement the open skies instruments should not be regarded as a failure, but rather, a strategy of gradual or phased liberalization. Staged liberalization is essential for the States to build a solid cooperation and attain mutual benefits from the Agreements. This thesis also points out that the air transport policy in Indonesia is consistent with the spirit of liberalization in ASEAN. However, its implementation is very much determined by the political deliberation between the government and the airline companies as well as the condition of air transport infrastructure.

This thesis suggests that the sub-regional air transport agreements in ASEAN play a significant role to expedite and move forward the liberalization process to the ASEAN single aviation market. This thesis also suggests that Indonesia should promote the ASEAN open skies agreements, through which it may expand its air transport industry and excel the competitiveness of its national carriers.

RÉSUMÉ

L'Asie du sud-est, un sous-ensemble de la région Asie-Pacifique, est le foyer d'un marché de l'aviation en pleine croissance. Pour les dix États membres de l'Association des Nations de l'Asie du sud-est (ASEAN), une plus forte intégration transfrontalière dans le secteur de l'aviation est importante pour soutenir l'agenda de la Communauté économique de l'ASEAN (AEC) et pour répondre aux impacts de la libéralisation mondiale du transport aérien. À cet égard, un ensemble d'accords de ciel ouvert et de protocoles d'exécution ont été conclus et ratifiés par les membres de l'ASEAN.

Bien que l'ASEAN ait réalisé des progrès substantiels dans la libéralisation régionale des transports aériens, la réalisation du marché unique de l'aviation semble exagérée. Certains obstacles pour parvenir à une plus grande libéralisation sont les droits de trafic limités et les exigences restrictives en matière de propriété et de contrôle, comme stipulé dans les accords. En outre, la politique intérieure disparate de ses membres a été un obstacle redoutable à la mise en œuvre intégrale des accords.

Le but de cette étude est double. Tout d'abord, il analyse de manière critique certaines dispositions essentielles fixées dans les accords de l'ASEAN sur le ciel ouvert en ce qui concerne la création d'un marché unique de l'aviation. Deuxièmement, cette thèse tente de faire la lumière sur la position de l'Indonésie vers la politique de l'ASEAN ciel ouvert. Dans ce cadre, cette thèse examinera les progrès du régime des cieux ouverts dans l'ASEAN et comment ce régime régional et la politique nationale de l'aviation en Indonésie devraient se renforcer mutuellement.

Cette thèse conclut que le long processus pour les membres de l'ASEAN de mettre pleinement en œuvre les instruments de ciel ouvert ne devrait pas être considéré comme un échec, mais plutôt, comme une stratégie de libéralisation progressive ou graduelle. La libéralisation par étapes est essentielle pour que les États puissent établir une coopération solide et obtenir des avantages mutuels découlant des accords. Cette thèse souligne également que la politique de transport aérien en Indonésie est conforme à l'esprit de libéralisation dans l'ASEAN. Cependant, sa mise en œuvre est très déterminée par la délibération politique entre le gouvernement et les compagnies aériennes ainsi que la condition des infrastructures de transport aérien.

Cette thèse suggère que les accords sous-régionaux de transport aérien de l'ASEAN jouent un rôle important pour accélérer et faire avancer le processus de libéralisation au marché unique de l'aviation de l'ASEAN. Cette thèse suggère également que l'Indonésie devrait promouvoir les accords de l'ASEAN sur le ciel ouvert, par lequel elle peut étendre son industrie du transport aérien et d'exceller la compétitivité de ses transporteurs nationaux.

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INTRODUCTION

A. Context of Study

The impact of liberalization in the global air transport industry is robust. It increases traffic, transforms the landscape of the aviation industry, and supports the process of social development in many nations. There are two main factors by which liberalization may boost passenger traffic.¹ First, liberalization infuses the market with a competitive atmosphere as it diminishes both tariff and non-tariff entry barriers. Consequently, airlines are forced to figure out the strategies to survive the competition and simultaneously to make money. The airlines can apply some strategies, such as price reduction, service quality improvement, and loyalty programs, which, in turn, attract more people to fly with them.

Second, liberalization enables airlines to expand their services to new destinations by configuring new routes through, for example, the use of hub-and-spoke networks. This strategy has enabled them to capture passengers from many parts of the world (including the remote areas with poor access to land and water transportation) and transport their passengers through their hub airports. In other words, a liberalized market offers a unique opportunity for the airlines to generate more consumers to use their service.

Moreover, liberalization creates a competitive environment where airlines are encouraged to improve efficiency. To stay efficient, the airlines in general apply better price mechanisms, invent new business models, and optimize available networks. Arguably, the airlines have more freedom to choose any market strategy to maximize their efficiency gains in a deregulated market. On the other hand, if an airline fails to operate efficiently, it will be thrown out from the market or merge with other airlines.²

Although the concept of liberalization in air transport has been widely accepted, it still lacks a universally agreed definition.³ Hence, the shareholders and stakeholders in this field have been divergent in deciding how and to what degree liberalization should be undertaken. The types of air

¹ Xiaowen Fu, Tae Hoon Oum & Anming Zhang. "Air Transport Liberalization and Its Impacts on Airline Competition and Air Passenger Traffic" (2010) 49, 4 Transp J 24 at 27.

² Ibid, at 28.

³ Anusha Wickramasinghe, *Liberalization of Air Transport in South Asia - Some Legal and Policy Issue* in David Timothy Duval (ed.). *Air Transport in the Asia Pacific* (Farnham [England]; Burlington, Vt.: Ashgate Publishing Ltd, 2014) at 236. See also Brian F. Havel. *Beyond Open Skies: A New Regime for International Aviation* (Austin: Wolters Kluwer Law & Business, 2009) at 584. Brian F. Havel defines liberalization as "a continuum or a political process that leads ultimately to a new paradigm of competitive behavior where a balance of benefits is replaced by a balance of opportunities."

service agreements⁴ and, specifically, the formulation of their provisions⁵ demonstrate different approaches in granting liberalization. Some States presume that a free market acts best to shape the industry, while some others believe that a protectionist approach is necessary to anticipate the destructive result of rigorous liberalization.⁶

In practice, liberalization manifests in deregulation and privatization.⁷ It materializes domestically through the removal of most regulatory controls and entry barriers and the change of actors in the business, from government monopolies to privately-owned companies.⁸ Eventually, domestic liberalization will expand internationally by the exchange of air service agreements between States. International liberalization, however, depends on the willingness of governments to accept a higher degree of competition and a certain “multinationalisation” of the corporate structures in air transport.⁹

An important breakthrough for liberalization was made when the United States introduced an open skies policy and disseminated an open skies agreement throughout the world.¹⁰ This fresh type of bilateral air service agreement was designed to trade “liberalization for liberalization” in place of “restriction for restriction”.¹¹ It traded the foreign access to interior American markets for guarantees of greater pricing flexibility and other “soft rights.”¹² To promote the open skies agreement, the US adopted “encirclement” tactics. Its approach was to enter into an open skies agreement first with smaller countries to use them as levers on the more resistant larger countries

⁴ Four types of air service agreements based on the scope of the contracting parties: Bilateral, Regional, Plurilateral, and Multilateral Air Service Agreement.

⁵ There are at least thousands of government bilateral air service agreements in the world, but the body of regulation generally bases upon the Bermuda I, Bermuda II or open skies model.

⁶ The study conducted by Roberta Piermartini and Linda Rousová concludes that the degree of liberalization in aviation market is limited to the level of income of the countries. They have benefited from negotiating air service agreements to adjust their level of economic welfare with the level of liberalization they aim for. See Roberta Piermartini and Linda Rousová, “Liberalization of Air Transport Services and Passenger Traffic”. World Trade Organization - Economic Research and Statistics Division, Staff Working Paper (2008) at 10-11.

⁷ Thomas R. Leinbach and Richard Ulack. *Southeast Asia: Diversity and Development* (USA: Prentice-Hall Inc, 2000) at 240.

⁸ Brian J. Graham. *Geography of Air Transport* (Chichester, England; New York: Wiley, 1995), at 52

⁹ OECD. *Deregulation and Airline Competition* (Paris: OECD, 1988) at 78-79

¹⁰ The US guidelines for an international aviation policy was introduced in October 1977. It was further developed by the US Department of Transportation (US DOT) and published in the following year. In the same year, President Carter signed the International Air Transport Negotiations after several public hearings were held. See Rigas Doganis. *Flying Off Course: the Economics of International Airlines* (London; New York: Routledge, 1992) at 53.

¹¹ Ibid

¹² Some US carriers criticized the soft right offered in this agreement: “nothing than the willingness of foreign governments to stop regulating entry, fares, and schedules.” See Jeffrey N. Shane, “Air Transport Liberalization: The U.S. Experience Global Symposium on Air Transport Liberalization” (Speech made at the ICAO Global Symposium On Air Transport Liberalization in Dubai, U.A.E. September 18, 2006) at 3.

(usually the neighbor). This strategy inevitably created a market pressure on other countries to join the bandwagon, as they were at risk of losing passengers to other airlines from the countries with an open skies regime.¹³

Meanwhile, the open skies agreements in Europe has an even greater degree of flexibility than that in the US. The Member States of the European Union (EU) have agreed to integrate their aviation market that allows the European airlines to enjoy domestic cabotage rights (Ninth freedom)¹⁴ and cross-border mergers with unrestricted capacities, frequencies, prices, and service levels.¹⁵

Notably, the market integration in the EU has inspired many other trading blocks to follow suit, including the Association of South-East Asian Nations (ASEAN). In ASEAN, air transport is perceived as the main fuel of tourism. Indeed, air transport is widely recognized as the very basis for economic development, especially in the tourism sector. Air transport and tourism are mutually reinforcing and inter-dependent in terms of greater accessibility and time-efficiency.¹⁶ More importantly, the aviation industry supports tourism and a range of international businesses by providing a rapid transportation network worldwide.¹⁷ It has increased opportunities for both leisure and business travelers to experience a host of geographies, cultures, and markets due to its speed, convenience, and affordability.

Asia-Pacific has been one of the world's fastest growing regions in terms of air travel. With travel and tourism accounting for 12.4% of its GDP in 2015 (according to the World Travel & Tourism Council), Southeast Asia has surpassed that of Asia Pacific's average of 8.5% and the global average of 9.8%.¹⁸ The surge in demand aligns with the geographic makeup of the region

¹³This tactics worked effectively in the region where traveling distances between major airports were relatively short, such as in Europe. Martin Staniland. *A Europe of the Air?: the Airline Industry and European Integration* (Lanham : Rowman & Littlefield, 2008) at 133.

¹⁴ Ninth freedom, or known as pure cabotage, means that an airline has the right to carry traffic from one point in the territory of a country to another point in the same country. Paul S. Dempsey. *Public International Air Law* (Canada: McGill University, 2008) at 26

¹⁵ Alessandro Cento. *The Airline Industry Challenges in the 21st Century* (Heidelberg: Physica-Verlag, 2009) at 1.

¹⁶ WTO recorded that about 40% of the 840 million international tourist arrivals in 2006 were by air. In long haul destinations, this figure could be even higher. Furthermore, the vast majority of the international passengers in 2006 were tourists. Ruwantissa Abeyratne, *Aviation Trends in the New Millenium* (England: Ashgate Publishing Ltd., 2001) at 167.

¹⁷ Julie Perovic, "The Economic Benefits of Aviation and Performance in the Travel & Tourism Competitiveness Index", The Travel & Tourism Competitiveness Report (2013) online: <www3.weforum.org/docs/WEF_TT_Competitiveness_Report_2013.pdf> at 57.

¹⁸ DBS Group Research, "Regional Industry Focus: ASEAN Travel & Hospitality" (2016) online: <www.dbsinsights.com/asean/opening-the-skies-on-aseans-tourism>.

as well as the vibrant and rapidly expanding middle class segment. This burgeoning market is also supported by the low-cost airlines that are in fierce competition for market shares.¹⁹ Airbus and Boeing, the world's leading aircraft manufacturers, have estimated that the demand for new passenger and freight aircrafts will remain high in the years to come.²⁰

According to the World Trade Organization (WTO), the total number of international arrivals to ASEAN is expected to increase to 123 million by 2020, 152 million by 2025 and 187 million by 2030.²¹ To keep these numbers on track, the ASEAN Air Transport Ministries have agreed upon the ASEAN Tourism Strategic Plan 2016-2025, which highlights the importance of air connectivity through the ASEAN Single Aviation Market (ASEAN SAM).²²

The ASEAN SAM is one of the key priorities in the overall ASEAN Economic Cooperation (AEC) scheme.²³ The single market was anticipated to come into effect with the ASEAN Open Skies Agreement (AOSAs) in 2015. The implementation of the ASEAN SAM is based on two AOSAs: The Multilateral Agreement on Air Services (MAAS) signed in 2005, and the Multilateral Agreement on the Full Liberalization of Passenger Services (MAFLPAS) signed in 2010.²⁴ Both Agreements provide for the relaxation of market access and the ownership and control of airlines that decrease the old-fashioned restrictions on the regional cross-border carriages.²⁵

However, the AOSAs, which were envisioned to support the realization of the AEC by 2015, were off to a slow start. Nearly one year elapsed before the Lao PDR and Indonesia eventually

¹⁹ John Bowen, *The Economic Geography of Air Transportation: Space, Time, and the Freedom of the Sky* (London; New York: Routledge, 2010) at 109.

²⁰ Airbus estimates that there will be no less than 30,000 new aircrafts for passenger and cargo available in the next decade, while Boeing expects more than 40,000. Among the aircraft order, the single-aisle models will most likely dominate the demand. See Airbus, "Mapping Demand 2016-2035: Global Market Forecast" online: <www.airbus.com/company/market/global-market-forecast-2016-2035/>. See also Boeing, "Current Market Outlook 2016-2035" online: <www.boeing.com/resources/boeingdotcom/commercial/about-our-market/assets/downloads/cmo_print_2016_final_updated.pdf>.

²¹ ASEAN. "ASEAN Tourism Strategic Plan 2016-2025" <http://www.asean.org/storage/2012/05/ATSP-2016-2025.pdf> at 4.

²² Ibid at 33.

²³ AEC aims at four key results: (1) a single market and production base; (2) a highly competitive economic region; (3) a region of equitable economic development; and (4) a region fully integrated into the world economy.

²⁴ In the meantime, ASEAN Members also had agreed on liberalization in cargo service through the adoption of the Multilateral Agreement on the Full Liberalization of Air Freight Services (MAFLAFS) in 2009.

²⁵ Ruwantissa Abeyratne, *supra* note 16, at 165.

ratified the MAFLPAS and its subsequent protocols.²⁶ It also took a considerable length of time for the Philippines to finally ratify the Protocol 5 and 6 of the MAAS.²⁷

Although all the ASEAN Members have unanimously agreed to adopt all of the Agreements, the ASEAN SAM has not come to materialize. Some crucial elements in a single market, such as free access beyond Seventh freedom, have not been fulfilled. In practice, ASEAN carriers are still restricted to connect two cities in the Member States' territory if their home State is not the point of departure or destination.²⁸ Moreover, the Agreements still do not avert the Members from treating the ASEAN carriers on the basis of who owns or controls the carriers. Some loopholes are also identified in the areas of competition regulation, air navigation services, and safety and security that are yet to be harmonized.

A major criticism has been addressed to Indonesia for its lethargic acceptance of the AOSAs. As an archipelago with the largest and most populous territory in the Southeast Asia region, it is the biggest market in the region.²⁹ From 2001 to 2014, air travel in Indonesia grew between 15 and 20 percent, surpassing 70 million, thus positioning the country as the world's fifth largest domestic market.³⁰ In 2016, there were no fewer than twenty scheduled airlines and forty-five non-scheduled airlines operating approximately fourteen-hundred commercial aircrafts over its sky. These airlines provide air services over 277 domestic routes and 129 international routes which connect 18 Indonesian cities with 51 cities in 27 countries.

In this respect, Alan Tan, an aviation law academic from the National University of Singapore, excoriates Indonesia's pending ratification:

²⁶ Indonesia and Lao PDR ratified the MAFLPAS Agreement and its implementing Protocols in early April 2016. See ASEAN Transport Instruments and Status of Ratification (As of March 2017), online: <<http://asean.org/storage/2012/05/Ratification-status-of-Transport-Agreement-as-of-March-2017.pdf>>.

²⁷ MAAS Protocol 5 on Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Capital Cities and MAAS Protocol 6 on Unlimited Fifth Freedom Traffic Rights Between ASEAN Capital Cities were signed in 2009. Yet, the Philippines ratified them only in March 2016. See Ibid.

²⁸ Asian Development Bank Institute, "ASEAN 2030: Toward a Borderless Economic Community" (2014) online: <<http://www.adb.org/sites/default/files/publication/159312/adbi-asean-2030-borderless-economic-community.pdf>> at 264.

²⁹ In large countries, including Australia, the US, Brazil, Russia, or those with a fractured geography (such as Indonesia, the Philippines, or Canada), air transport has a significant edge over terrestrial modes because of the time-savings that it can offer. Brian J. Graham, *supra* note 8, at 54.

³⁰ Indonesia ranked four after the US, China, Japan and Brazil. Airline Leader, "INDONESIA: Slower growth in the world's fifth largest domestic airline market" (Issue 33, 2016) online: <www.airlineleader.com/categories/regions/indonesia-slower-growth-in-the-worlds-fifth-largest-domestic-airline-market-270806>.

"since Indonesia constitutes half of ASEAN's population, it's a huge gap. It's a bit like the European Union doing this without France, Germany and Britain combined."³¹

Therefore, it is plausible to say that Indonesia has a significant contribution to the success of the open skies regime in ASEAN. In this respect, it is important to understand how the open skies policy is adopted in Indonesian aviation law and applied in its domestic market. Such analysis will bring forward a meaningful perspective as to the action Indonesia should undertake in response to the results of the open skies regime in ASEAN.

B. Problem Statement and Thesis Outline

Southeast Asia is the home of a rapidly growing aviation market. ASEAN is a unique regional grouping where the ten Member States have significantly different political backgrounds and disparate levels of economic development and competitiveness. As a result, the ASEAN Members share little agreement on what should or should not be permitted into the single aviation market scheme, particularly in relation to market access and ownership and control rules.

The importance of this study lies in the outcomes that regional open skies agreements in ASEAN might bring to advance liberalization in the international air transport sphere in general, and in Asia in particular. Considering the conflict of interest among the Member States and the promising benefits of the regional open skies policy, this thesis will examine how open skies agreements work in ASEAN and what is envisioned. Subsequently, this thesis will flesh out the deregulation process in the Indonesian aviation industry and where it stands in relation to the ASEAN SAM agenda.

It is worth noting that, before examining the ASEAN integration more deeply, one may question the significance of regional open skies in relation to the liberalization of air transport worldwide. What encourages the States to embody such a cooperation? While the regional agreement may seem more complicated than the bilateral structure, it also may appear to be less complex as fewer States are involved. How does regional integration result in a different impact to international liberalization as compared to bilateral cooperation? These questions will be discussed in Chapter I.

³¹ Karamjit Kaur, "ASEAN's Open Skies Dream" (2014) online: <www.thejakartapost.com/news/2014/02/28/aseans-open-skies-dream.html>.

In Chapter II, we will learn how a regional economic group consisting of economic-fragmented States formulates a multilateral regional open skies arrangement, reflecting the conditions of Southeast Asian countries. What kind of single market is anticipated by ASEAN amidst such substantial divergence among its Members? How does the open skies policy adopted in the AOSAs affect or facilitate the prospect of a single aviation market? Chapter II will present the background behind the adoption of the AOSAs and examine the regulatory frameworks that have been stipulated by the Member States in the course of a greater regional integration.

As is previously mentioned, the road to the ASEAN SAM has allegedly been conflicted by its key member, Indonesia. Accordingly, Dr. Ruwantissa Abeyratne asserts that Indonesia's closed economy, with a tendency to be protective, may impede the implementation of the AOSAs.³² Arguably, this claim seems to be at odds with the deregulated air transport industry in Indonesia. To what extent does national deregulation in Indonesia shape the country's position towards the AOSAs? What are the commitments made by Indonesia in the AOSAs and what is their significance to achieving the ASEAN SAM? Chapter III will elaborate the legal and policy frameworks of the air transport industry in Indonesia, including its stance towards liberalization.

Finally, Chapter IV will conclude the analysis and synthesis provided in Chapters II and III and offer recommendations regarding the future implementation of open skies agreements in ASEAN and in Indonesia.

³² Ruwantissa Abeyratne, *supra* note 16, at 172.

CHAPTER I

REGIONAL OPEN SKIES AGREEMENT AND SINGLE AVIATION MARKET: LITERATURE REVIEW

The structure of the air transport industry is unique; while its operation is international in nature, national regulations still have exclusive jurisdiction, especially in governing the ownership and control of the airlines.³³ This paradoxical characteristic has a critical impact on achieving global economic regulation by means of a multilateral agreement.³⁴

Since the failure of the Chicago Conference to compromise the policy debates on economic liberalism *vis-à-vis* national protectionism, States promote the internationality of air transport through bilateral arrangements.³⁵ The proliferation and evolution of Bilateral Air Services Agreements (BASA) have been helpful in circumventing the problems resulting from the paradox in the air transport industry.³⁶ Beside the agreements between two States, some like-minded States or States situated within close geographical proximity have promoted air transport liberalization by means of regional or plurilateral arrangements. Such an intergovernmental cooperation established so-called "regional open skies agreements".

³³ See Ruwantissa Abeyratne, *Air Law and Policy*. (USA: Publish America, 2007) at 188.

³⁴ According to Bonin, reasons propounded for holding back the exchange of hard rights through multilateralism include the fear of acquisition of its national carriers ownership by a foreign carrier and the loss of international prestige upon the dissolution of the national "flag" carrier. Moreover, some States have a concern of its failure to fulfil its public service obligations to its citizens or surrendering advantages of a large domestic market to foreign carriers as a consequence of multilateral agreement. See Jason R. Bonin, "Regionalism in international Civil Aviation: A Reevaluation of the Economic Regulation of International Air Transport in the Context of Economic Integration" 12 SYBIL 113 (2008) at 116.

³⁵ The Chicago Conference was initiated by the US President who called upon the representatives of 54 nations to meet at Chicago from 1 November to 7 December 1944. The original purpose of this Conference was to discuss an international regulation in governing air routes and services. The Conference did not reach an agreement on the granting of traffic rights. However, the result of the Conference had successfully adopted the Convention on International Civil Aviation (Chicago Convention) and established the International Civil Aviation Organization (ICAO), the two fundamental source of law and institution in the field of international civil aviation. See Michael Milde, *International Air Law and ICAO*, Second Edition, in *Essential Air and Space Law*, vol. 10, edited by Marietta Benko, (Netherlands: Eleven International Publishing, 2016) at 13-16.

³⁶ Rigas Doganis conceives that national regulatory restrictions affect the international characteristic of air transport operation. Domestic inhibition becomes more obvious when it deals with international liberalization. This stems from the structure of air transport business that has never been seen as a free-standing sector of the economy, but rather as one component in an array of factors involved in social and economic development. See Rigas Doganis, *The Airlines Business in the Twenty-First Century* (London; New York: Routledge, 2001), at 17.

A. Regionalization, Regional Integration, and Regional Cooperation

“Regionalization” refers to the growth of societal integration within a region, as well as the often undirected processes of social and economic interaction. The term places particular weight on autonomous economic processes which lead to higher levels of economic interdependence within a given geographical area, as opposed to between that area and the rest of the world. Regionalization, as a cooperative arrangement, can serve a wide variety of purposes. It may serve as a means of responding to external challenges and of coordinating regional positions in international institutions or negotiating forums. It also can be developed to secure welfare gains, to promote common values or to solve common problems.³⁷ The most important driving forces for economic regionalization come from markets, private trade and investment flows, and from the policies and decisions of companies.³⁸

Joseph Nye identifies two major classes of regional organization: first, micro-economic organizations that include the formal economic integration, and second, macro-regional political organizations that include political and conflict management.³⁹ Indeed, most of the regional groupings were initially established based on political and security considerations, and the participating States extended their scope of application to the economic field. The present discussion, however, will focus on elaborating the first classification, namely the regional organization on the basis of economic cooperation.

Regional integration is a term that is broader in scope than regional cooperation. “Regional integration” refers to a process through which economies in a region become more interconnected as a result of market-led and private-sector-driven actions and/or government-led policies and collective initiatives in a region. Meanwhile, “regional cooperation” refers to collective policies and initiatives by the governments that, in turn, could be either formally embodied in an intergovernmental treaty or informally agreed upon by the participating countries. However, the two processes can be mutually reinforcing. Regional cooperation may intensify regional

³⁷ Andrew Hurrell, “Explaining the Resurgence of Regionalism In World Politics” 21 *Rev of International Studies* 331 (1995) at 336.

³⁸ *Ibid*, at 334. Besides market forces, regionalization is also helped by migration and social networks which lead to interaction and interconnectedness between States creating new cross-border regions.

³⁹ Joseph S. Nye, “Peace in Parts: Integration and Conflict in Regional Organizations” in Andrew Hurrell, *ibid.* at 331.

integration and, simultaneously, increased regional integration may persuade the governments to cooperate collectively.⁴⁰

According to Andrew Hurrell, “regional economic integration” is an important sub-category of “regional cooperation”. “Regional economic integration” refers to a natural outcome of the globalization process. Globalization calls for greater connectivity that has prompted many governments to introduce several key regional cooperation initiatives in the areas, such as cross-border infrastructure development, trade and investment, money and finance, and the provision of various regional public goods in the health and environment sectors.⁴¹

Economic cooperation and integration at the regional level have an even greater, impact on poverty reduction. Normally, it is very difficult for a small, poor countries to have direct access to the global markets as they may lack physical connectivity, market expertise, or distribution networks. By integrating with bigger economies, these underdeveloped countries will have more opportunities to participate in the regional and global supply chain.⁴²

B. Regional Cooperation In Air Transport Industry

Regionalism adopts the elements of multilateralism but is limited to a specific geographic context.⁴³ Under the regional approach, certain countries conclude a multilateral air service agreement intended to govern air transport operations within the boundaries of (and in some cases outside) that continent or subcontinent. Thus, any agreement signed under a regional model may be considered as a multilateral agreement. While it may be categorized as “regionalism”, it should be distinguished from “multilateralism” which is more global in scope and beyond the geographical and political boundaries.⁴⁴

⁴⁰ Ibid, at 1.

⁴¹ Asian Development Bank (ADB). “Regional Cooperation and Integration Strategy” (2006) online: <www.adb.org/documents/policies/RCI-strategy/final-RCI-strategy-paper.pdf> at 3.

⁴² ADB, supra note 41, at 8.

⁴³ Multilateral approaches in international air transport can be divided into a global multilateral (full multilateralism), plurilateral (phased multilateralism), and regional approach. The global approach implies a world-wide participation of countries in aviation-specific issues regardless of their size or share of international air transport, for instance the International Civil Aviation Organization (ICAO) and the World Trade Organization (WTO). The plurilateral approach entails “a gradual branching out from a core of like-minded States that establish a fully liberalized air transport markets among themselves.” The example of plurilateral agreement is the Multilateral Agreement on the Liberalization of Air Transport (MALIAT). See Jae Won Lee, *Regional Liberalization in International Air Transport: Towards Northeast Asian Open Skies* (The Netherlands, USA: Eleven International Publishing, 2016) at 27-28.

⁴⁴ J. Gunther, Multilateralism in International Air Transport”, 1994 19:1 Ann. Air & Sp. L. at 261-262

Dr. Ruwantissa Abeyratne reveals that the basic objective of a collective agreement is to provide greater market access and improve services among the States who share similar concerns. A small grouping enables States to agree on the provisions to open up their airspace more easily, rather than a big fragmented association. In turn, it simplifies the management of the air transport industry in a liberalized environment as a result of regional negotiation.⁴⁵

The benefits of regionalism in air transport liberalization are twofold. First, it allows like-minded States to secure initial compromises, which suggests that multilateral compromises may be easier to arrive in later on. Second, regionalism benefits developing countries because, individually, they may not be able to negotiate effectively on market access with dominant countries like the US. However, as a regional group, they will be able to reap the benefits of a stronger negotiating position, thus enabling their joint airlines to compete on more favorable terms in the international market place.⁴⁶ Therefore, regionalism represents the opportunity for developing countries to strengthen their positions in the global air transport market. Instead of maintaining isolated markets, smaller countries from the same area may build common interests and cooperate in order to become a strong community so that they may compete with other strong economic regions.⁴⁷

Developed countries also need regional cooperation to strengthen their regional economies. In this respect, the purpose of integration is to compete more equally with bigger economies, such as those within the EU. An important result of regional integration in the EU is the substantial increase in airlines' flight frequencies between secondary airports and European hubs. This event significantly increases the threat of traffic diversion that, eventually, escalates the competitive pressure between airlines' networks as well as between European hub airports.⁴⁸

The relationship between regionalization and liberalization is portrayed by Bonin:

“Regional economic integration represents a manifestation of cooperative political will, and as such a means to progressively liberalize the economic regulation of the air transport industry while protecting the legitimate interests of States in, as well as the suppliers and consumers of air transportation.”⁴⁹

⁴⁵ Ruwantissa Abeyratne, *supra* note 33, at 286.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ David w. Gillen, et.al. (eds.). *The Impact of Liberalizing International Aviation Bilaterals: The Case of the Northern German Region* (USA: Ashgate Publishing Company, 2001) at 37.

⁴⁹ Jason R. Bonin, *supra* note 34, at 122.

In a nutshell, air transport integration provides a mechanism for the gradual liberalization of air transport on a global scale and the possibility of real gains in the overall integration of the regions.⁵⁰

A similar view is also shared by de Palacio and Jeannot, declaring that the regional agreements may work as a bridge to full liberalization. This is started by eliminating the market barriers and the limits on transnational investments between a small group of States. At the end, such an agreement may be progressively extended to larger States. The significance of applying the regional approach is that some sensitive aspects in the first phase, such as traffic rights, national security, and ownership are less difficult to be liberalized as the regional partners usually share equal characteristics and interests.⁵¹

C. Regional Open Skies Agreements

One notable development in the liberalizing trend is a considerable increase in the number of bilateral agreements invoking unrestricted market access provisions. These agreements generally provide for unrestricted route and operational rights, as well as Third to Fifth and Sixth freedom rights. Many also grant Seventh freedom rights for all-cargo services.⁵² These types of agreements are recognized as open skies agreements.

As noted in the previous discussion, States are more attracted to open their domestic aviation industries to their neighbors or any State that has a similar culture or ideology, rather than opening the industries worldwide. Bilateral open skies agreements initiated the process of the liberalization of international air transport, and this was fast forwarded by the regional open skies agreements. It is, therefore, useful to examine the connection between bilateral and regional open skies regimes as is elaborated below.

⁵⁰ Ibid, at 131.

⁵¹ Isabelle Lelieur, *Law and Policy of Substantial Ownership and Effective Control of Airlines: Prospects for Change* (USA: Ashgate Publishing Company, 2003) at 119.

⁵² Ruwantissa Abeyratne, *supra* note 33, at 266.

C.1. Open Skies Agreements

The open skies policy was first introduced by the US in the Carter Administration in 1978.⁵³ Within this year, the first generation of open skies agreements was signed between the US and two major Benelux Countries (the Netherlands and Belgium), as well as Israel. Accordingly, the first open skies agreements were well-known as the Benelux-type bilateral. These are characterized by their opportunities for pricing flexibility, unrestricted capacity, and multiple designations. They are also known to offer access to the interior US markets for foreign flag carriers and advocate new Fifth freedom rights, country of origin charter rules, and elimination of discrimination and unfair methods of competition.⁵⁴

The second generation of open skies agreements was established in the 1990s when the US adopted a negotiating strategy of offering code sharing and antitrust immunity approval. The American government began the more liberal open skies regime by amending the 1978 agreement with the Dutch government in 1992.⁵⁵ As time went by, these agreements involved not only developed countries but also an increasing number of developing countries with two-thirds of them involving the US as one of their partners.

In other parts of the world, the European Common Aviation Area Agreement (ECAA) came into force in 1992. The agreement allows any European carrier, under the EU auspices, to establish a new route or base anywhere within the EU territory without prior approval by the host countries. Shortly thereafter, Canada and the US began negotiating an open skies agreement, which was expanded. In a similar manner, Australia and New Zealand created a Single Air Market.⁵⁶ Moreover, a few countries signed the first trans-oceanic multilateral open skies agreement, namely the Multilateral Agreement on the Liberalization of International Air Transport (MALIAT), with

⁵³ The first important step was the repudiation of the IATA tariff system. The US also began to renegotiate its air services agreements in order to introduce a liberal environment for its air carriers. The first generation “open skies” agreements was signed in 1978, before the Airline Deregulation Act came into force. Jan Walulik. *Progressive Commercialization of Airline Governance Culture* (New York: Routledge, 2016) at 87.

⁵⁴ Paul S. Dempsey, *supra* note 14, at 536.

⁵⁵ *Ibid.*, at 544.

⁵⁶ Australia and New Zealand established a Single Aviation Market (SAM) arrangement that came into force on 1 November 1996. It granted airlines of both countries “unrestricted rights to fly anywhere within the other country and have unrestricted rights to fly trans-Tasman services.” Four years later, this arrangement was formalized by the open skies agreement by both countries. In 2002, Australia and New Zealand officially signed the agreement, which allows the SAM carriers to exercise beyond rights and Seventh Freedom rights for all-cargo services. This Trans-Tasman SAM was further relaxed in 2016, when the Australian government enacted a legislation that endowed New Zealand airlines domestic cabotage rights in Australian territory. See ICAO Secretariat, “Trans Tasman Single Aviation Market” (July, 2007) online: https://www.icao.int/sustainability/CaseStudies/StatesReplies/Trans-Tasman_EN.pdf

the US.⁵⁷ By the end of 2008, both Canada and the US had reached open skies agreements with the EU and New Zealand, and the US had signed an agreement with Australia. In the same year, Australia and New Zealand had discussed an open skies agreement with the EU.⁵⁸

While the ‘open skies’ term is widely used to classify a liberal air transport agreement, the words lack an official definition.⁵⁹ This term simply refers to a general policy of liberalizing international aviation markets. An open skies agreement commonly grants the carrier of one State unrestricted access into the sovereign territory of another State without any explicit specification of routes, fares, capacity, points of destination/departure, or schedule of services. In other words, this regulatory approach allows the foreign carrier of one State to land at any airport of another State on any number of occasions with unlimited seat capacity.⁶⁰

An open skies agreement is an improvement on the rigid old-style bilateral agreement, as it allows for the relaxation of restrictions on flight frequencies, capacity, airports of departure and arrival, and prices.⁶¹ It also frees up access to all points in each country and allows unconstrained code-sharing.⁶² This agreement is a type of air services agreement whereby the contracting parties exchange freedoms of the air in a generous and liberal manner.

Open skies agreements have equipped airlines with an unprecedented ability to compete with each other. Ideally, the “open skies” formula gave the airlines of each signatory country virtually complete freedom to choose which routes they may fly between the country of origin and that of destination, how many flights they may offer, and what fares they may charge.⁶³ Eventually, this side-effect of open skies is good for tourism and for consumers, as has become evident in the experience of the EU. Eight years following the creation of the EU Single Aviation Market (1992), the number of intra-EU routes served by more than two carriers had increased by 256%, discount economy fares had declined by 34%, and the total number of intra-EU city pairs had increased by

⁵⁷ Multilateral agreement initiated by Brunei Darussalam, Chile, New Zealand, Singapore, and United States of America, signed on May 1, 2001 and entered into force on 21 December 2001. Other contracting parties: Cook Islands, Mongolia (only cargo), Samoa, and Tonga. Peru withdrew its membership in July 2005.

⁵⁸ Peter Paul Fitzgerald. *A Level Playing Field for Open Skies: the Need for Consistent Aviation Regulation*, in *Essential Air and Space Law*, vol. 15, edited by Marietta Benko, (Netherlands: Eleven International Publishing, 2016) at 74-75.

⁵⁹ Jan Walulik, *supra* note 53, at 87.

⁶⁰ James Jordan, “ASEAN Liberalization: Open Skies Achieves Full Ratification” (2016) online: <www.hfw.com/ASEAN-liberalisation-open-skies-achieves-full-ratification-May-2016>

⁶¹ Brian Hindley. *Trade Liberalization in Aviation Services: Can the Doha Round Free Flight?* (DC: The AEI Press, 2004) at 2.

⁶² The Netherlands was the first country to sign an open skies agreement with the US.

⁶³ Martin Staniland, *supra* note 13, at 133.

74%.⁶⁴ Meanwhile, in the US, the open skies policy has proven to be beneficial to all travelers. Those gaining the most in terms of lower fares have been passengers traveling from a US gateway city to beyond a European gateway city.⁶⁵

Nevertheless, these open skies agreements have never established an entirely free and open aviation market. One of the remaining barriers is the airline nationality requirement. These agreements decline to transform the traditional conditions for the withholding or revocation of rights granted, which still include a strict substantial ownership and effective control rule.⁶⁶ Even if this restriction is relaxed, the exchange of broader or full market access rights between States would usually be country-specific. Most States which have concluded bilateral open skies agreements do not reflect their agreements as a general policy reach, nor do they contemplate these rights with all their aviation partners. The traffic rights are conferred only on a case-by-case basis.

⁶⁷

C.2. Regional Open Skies Arrangements

International civil aviation has been dominated by a complex network of bilateral air services agreements. After the deadlock in the Chicago Conference, the bilateral structure was a cardinal solution for States having a strong willingness to expand their air transport industry globally through the grants of access rights. As noted above, however, bilateral agreements had become a hindrance to effectively spreading the liberalization of the aviation market due to embroidered restrictions imposed by protectionist governments.

Nonetheless, a comprehensive multilateral agreement with the particular purpose to internationalize the economic regulation in the air transport industry is not anticipated in the near future. Brian Havel contends that the global air transport industry may be ‘the most complicated

⁶⁴ Dempsey, *supra* note 14, at 127-128.

⁶⁵ In the US DOT report in 2000, transatlantic airfares were shown to have fallen considerably as a result of the open skies regime. A number of different types of market were considered, including behind gateway to beyond gateway (BB), behind gateway to gateway (BG), gateway to beyond gateway (GB), and gateway to gateway (GG), provided that a gateway is a major hub airport in the respective country. Between 1996 and 1999, passengers traveling under the open skies agreement, enjoyed lower airfares approximately 20% than those traveling without the open skies agreement, for example the KLM/Northwest passengers who travelled from Detroit to Vienna via Amsterdam. See George Williams. *Airline Competition: Deregulation's Mixed Legacy* (USA: Ashgate, 2002) at 155.

⁶⁶ Jan Walulik, *supra* note 53, at 88-89.

⁶⁷ Ruwantissa Abeyratne, *supra* note 33, at 266.

field of endeavor ever attempted by the man'⁶⁸; thus, States are cautious to agree on a legal regime governing specific aspects of the industry. As for the prospect of achieving an intergovernmental agreement in air transport, Paul Dempsey notes:

“[...] Economic conditions and policies vary greatly from nation to nation; no nation, not even the United States, can unilaterally impose its aviation policy on the world community. So long as nations pursue their national interests, be they political, economic or military, there will undoubtedly be conflict in international civil aviation.”⁶⁹

Accordingly, regional arrangements may act as a catalyst for air transport liberalization by establishing a regional open skies agreement. Theoretically, regionalism offers a more promising and optimistic future for the move towards a liberal aviation environment because it contains less conflicting interests compared to those of a larger group of countries. In this regard, liberalization is crucial, especially in Southeast Asia, where flag carriers enjoy overwhelming dominance in their countries, as liberalization increases the exposure to international trade.⁷⁰

According to ICAO, the world now is divided into regional, sub-regional⁷¹ and plurilateral⁷² open skies agreements.⁷³ Regional open skies arrangements have widely spread to Europe, Africa, Asia, Australia and Latin America. Oftentimes, the agreements are adopted as one sub-sector out of various areas of the free trade agreement (FTA) concluded between the countries in those continents.⁷⁴ Some regional open skies agreements under the ICAO list include the Andean Pact,

⁶⁸ Brian Havel, *supra* note 3, at 8.

⁶⁹ Paul S. Dempsey, *Law and Foreign Policy in International Aviation* (USA: Transnational Publishers, Inc., 1987) at 75.

⁷⁰ See John T. Bowen Jr. And Thomas R. Leinbach, “Development and Liberalization: the Airline Industry in ASEAN” in Gary C. Hufbauer and Christopher Findlay (ed.). *Flying High: Liberalizing Civil Aviation in the Asia Pacific* (DC: Institute for International Economics, 1996) at 84.

⁷¹ Sub-regional open skies agreements have a limited coverage to a specific region in a State, for example the Memorandum of Understanding on Expansion of Air Linkages IMT-GT (signed and entered into force on 10 Apr 1995 between Indonesia, Malaysia, and Thailand (amended on 4 Sep 1996, 12 Jan 2001 and 11 Aug 2006, known as Indonesia-Malaysia-Thailand Growth Triangle)) and the Memorandum of Understanding on Expansion of Air Linkages BIMP-EAGA (signed and entered into force on 21 Feb 1995 between Brunei Darussalam, Indonesia, Malaysia, and the Philippines (known as Brunei Darussalam, Indonesia, Malaysia, and Philippines-East Asian Growth Area)).

⁷² This term is used in the WTO type of agreements to include the subset agreements after the Uruguay Round that have a narrower group of States. See online: <www.wto.org/english/thewto_e/whatis_e/tif_e/agrm10_e.htm>. According to the ICAO's list, MALIAT falls under this category.

⁷³ See ICAO, Regional / Plurilateral Agreements and Arrangements for Liberalization, online: <www.icao.int/sustainability/Documents/RegionalAgreements.pdf> .

⁷⁴ See Hélène Lapointe. “Regional Open Skies Agreements: Law and Practice” LL.M. Thesis, McGill University (1995). She reviews the relationship between the free trade area and the regional open skies regime in Europe, Latin America, Australia, Asia, and North America. Lapointe concludes that the liberalization of international air transport services will unlikely be achieved on a world-wide basis through multilateral agreements like the General Agreement on Tariffs and Trade, but through free commercial exchanges and cooperation between neighboring like-minded countries.

Yamoussoukro Decision, the European Community, Caribbean Community and Common Market (CARICOM), *Mercado Comun del Sur* (Mercosur), Arab League, and the Association of South-East Asian Nations (ASEAN).

Before the regional aviation integration in ASEAN is analysed further, it is worthwhile to understand how a regional open skies agreement or arrangement is formulated and enforced in different regions.

C.2.1. Andean Pact⁷⁵

The Andean Countries of Bolivia, Colombia, Chile, Ecuador and Peru signed the *Cartagena Agreement*⁷⁶ on 26 May 1969, which give birth to the Andean Community.⁷⁷ In 1973, Venezuela adhered to this Agreement and in 1976 Chile withdrew from it.

In November 1990, the Andean Aeronautical Authorities Committee (AAAC) met in Caracas, Venezuela when the open skies idea was casted before the Presidents of the Member Countries. The result of this meeting was “Andean Subregional Air Transport Integration”, which entered into force in 1991 under Decision 297.⁷⁸

Although this open skies initiative is regarded as taking the scheme of the Venezuela-Colombian Bilateral Air Transport Agreement⁷⁹ (which was considered liberal in that era), the regional open skies agreement in the Andean Community was revolutionary. The Members did not stop after exchanging the traffic rights to Fifth freedom, but they went beyond that to include cabotage rights.⁸⁰

With respect to substantial ownership and the effective control principle, the Andean Community Commission proposed the concept of mixed enterprise. The company must contain the minimum amount of national ownership between 51% and 80% in order to be considered as ‘mixed’ enterprise and, thus, become qualified to benefit from the special regime. The Competent

⁷⁵Mauricio Siciliano. “The Andean Subregional Air Transport Integration System” LL.M. Thesis, McGill University (1995).

⁷⁶ Signed in the city of Cartagena de Indias (Colombia) on 26 May 1969.

⁷⁷ Also known as *Andean Pact*, *Andean Group* or *Andean Community*.

⁷⁸ *Decision 297*, Sixty-third Extraordinary Session of the Commission, 16 May 1991, Caracas (Venezuela).

⁷⁹ *Bilateral Air Transport Agreement signed by Colombia and Venezuela* 8 May 1991, in force since 7 July 1991. This agreement accords unlimited frequencies, capacities, routes and time schedules up to Fifth freedom of the air. The bilateral agreement also stipulates multiple designation principle, which was still uncommon at that time. With regards to the nationality rule, the bilateral recognizes the traditional substantial ownership and effective control in the text and grants the Contracting Party a discretionary power to reject the airlines of its counterparts.

⁸⁰ Eighth freedom (consecutive cabotage).

National Authority of each Member will evaluate whether the amount set as the minimum is reflected in the technical, financial, administrative, and commercial direction of the enterprise.

Air transport integration in the Andean Community has gone through an unusual process, wherein a “big bang” approach is used. There was no gradual or staged liberalization as most of the typical regimes had experienced. Decision 297 was legislated with a general policy and principles, and some adjustments or amendments followed.

As a result, the regional open skies regime brought negative effects to the Andean Market. One important factor behind the drawback was the failure of the Members to conform their national legislation and BASA to the *Andean Sub-regional Integration Air Transport Policy*. Moreover, the Members did not fulfill their obligations under the Decision by, for instance, giving preferential treatment to certain sub-regional and extra-sub-regional air carriers. The Andean supranational institution,⁸¹ the Andean Court of Justice, failed to properly adjudicate these violations because there was a tacit agreement between the Members to disregard the court order. Other contributing factors, such as rigorous penetration from third countries’ airlines (mainly from the US and the EU), rising fuel prices, and high taxes and tariffs played significant roles in delaying a successful implementation of air transport integration in Andean countries.

C.2.2. Fortaleza Agreement

The Fortaleza Agreement was a shy but confident beginning of integration in the 90s. In December 1996, a sub-regional agreement on air transport named Fortaleza Agreement was decided by the four Mercosur full Members as well as two associated countries: Bolivia and Chile. In 2000, Peru also joined this agreement, followed by Argentina in 2003. Although the Parties are Mercosur States, the Fortaleza Agreement has distinct characteristics as of Mercosur in many respects, such as the elaboration process, the territorial scope of application, the authorities, and the dispute settlement mechanisms.⁸²

⁸¹ The regime established by the ANCOM is supranational since it has various bodies that issue different levels of binding legislation to the Member countries. The bodies are: a. a legislative body (the Commission) to issue regulations; b. an executive body (the Board) to administer the organization and enforce the Decisions and Resolutions; and c. a judicial body (the Andean Court of Justice) to control the application of the laws emanating therefrom.

⁸² Da Silva, “Air Transport in the Mercosur, Airlines Magazine,” e-zine edition, Issue 31, https://www.scribd.com/document/117503285/31-Candido-Da-Silva-Air-Transport-Mercosur#download&from_embed at 2.

This agreement envisioned the development of new regional air services, in addition to those operated under the bilateral agreements that covered only ten points of departure and arrival.

The traffic rights granted in agreement are relatively strict,⁸³ although Art.1 paragraph (2) do not exclude Fifth and Sixth freedom. This provision stipulates that a further authorization from the Member concerned is required to grant these last two freedoms. Nevertheless, there is a possibility to make a further integration as stipulated in the Art 18. It specifies periodical revision of the agreement in order to gradually eliminate the restrictions. Thus, the Council of the National Air Transport Authorities has been meeting every year, establishing goals for a further integration at the regional level.

There is an engagement to the legal *rapprochement* between the National Air Transport Authorities in the authorizations of routes, frequencies, and schedules for regular flights as well as the commercial and operational activities.⁸⁴ Art.6 of the Annex C clarifies that the resolutions are adopted by simple majority at the Council, which shows the path of integration by avoiding the inter-governmental approach with the unanimity vote. However, it is written in the same article that such resolutions must be seen as recommendations to the Member States. These resolutions are not binding, yet they become a foundation on which the Arbitral Commission awards are based. The Commission is in charge of conflict resolution, and its decisions are binding (Annex D).

However, given that the decisions are not supranational, the last meetings have been characterized by an impasse between the liberal Chilean position and the conservator Brazilian one. Brazil has not defined a clear policy on the subject whereas Chile, with its well-defined regulatory framework, has chosen the open sky policy. In other words, the goal of the Agreement to achieve regional integration has been inhibited by the discretionary actions of the aeronautical authorities of the Member States.

C.2.3. Yamoussoukro Decision

The integration of African air transport market was set into motion since 1988 when the ministers in charge of civil aviation of 40 African States met in Yamoussoukro, Côte d'Ivoire. The meeting gave birth to a new African air transport policy called the Yamoussoukro Declaration. The Declaration set forth the commitment to integrate the African airline market under a liberalized

⁸³ The freedoms granted are First, Second, Third and Fourth freedoms (except those routes defined by the bilateral agreements).

⁸⁴ Art 8 of Fortaleza Agreement.

regime within the period of eight years.⁸⁵ A decade later, the Decision relating to the implementation of the Yamoussoukro Decision concerning the Liberalization of Access to Air Transport Markets in Africa (hereinafter: Yamoussoukro Decision) was finally passed and formally adopted in 2000.

The Decision came into force on 12 August 2000, granting all State Parties unlimited Third and Fourth freedom. Unlimited Fifth freedom is granted under certain circumstances: a) to sectors where no Third and Fourth freedom operations exist for economic reasons; and b) if Third and Fourth freedom exists in such routes, airlines can only offer capacity up to a certain percentage during any given period of time.

With respect to tariffs, any increase would require a notification to the appropriate authorities although no approval is required. Meanwhile, any decrease would take effect immediately.⁸⁶ With respect to the number of frequency and capacity, no restriction is imposed for the volume of traffic, the type of aircraft, or the number of flights per week. However, this right is subject to a conditional clause whereby States may limit traffic for environmental, safety, or technical reasons.⁸⁷

The Decision also allows for multiple airline designations, subject to the eligibility criteria that maintain a strict principal place of business and traditional effective control principle. However, multinational airlines may be effectively controlled by more than one State Party. A State Party may designate any eligible airline from another State Party to operate air services on its behalf, including an eligible African multinational airline of which it is a stakeholder.

The Yamoussoukro Decision seemed to be constructed under an ambitious treaty framework but, in practice, fell short in achieving its main goal: the integration of the African aviation market.⁸⁸ On a regional basis, only West and Central Africa have fully achieved the liberalization

⁸⁵ The eight years period are subdivided into three phases. Phase I (two years) was focusing on maximizing capacity usage between carriers. This was to be achieved by exchanging technical and capacity data, preparing for the designation of gateway airports, and promoting cooperation among national carriers so they could merge into larger and more competitive airlines. Phase II (three years) arranged the airlines to joint operations on international routes. In addition, certain airline operations were conducted jointly to achieve better economies of scale and deeper integration. The recommendations were to institute a common insurance mechanism and a computer reservation system, to purchase spare parts and aircrafts, to undertake promotion and marketing, to provide training, and to maintain the equipment. Phase III (three years) was to be used to strive toward achieving the complete integration of airlines by establishing some joint airline operations or entities.

⁸⁶ Art 4 of Yamoussoukro Decision.

⁸⁷ Art 5 of Yamoussoukro Decision.

⁸⁸ The Decision has a long history of failed or ineffective objectives to integrate Africa. As of 2010, 10 countries that are not parties are Djibouti, Equatorial Guinea, Eritrea, Gabon, Madagascar, Mauritania, Morocco, Somalia, South Africa, and Swaziland.

of air services in terms of policy implementation. The Decision is hardly implemented by the countries in the Northern and Southern part of Africa, and still progressing in East Africa. The Yamoussoukro initiative is indeed a relatively progressive and radical move from long-standing restrictive bilaterals. However, the implementation of the decision has encountered formidable challenges due to the lack of its key policy elements and the actual condition of the air transport industry of its Members. According to the African Union, among the reasons of the slow implementation of the Yamoussoukro Decision are: the lack of tools and funds for monitoring implementation of the decision, the lack of clear and independent responsibilities assigned to the Regional Economic Communities (REC),⁸⁹ and the establishment of the monitoring mechanism without any clearly defined power to prescribe rules.⁹⁰

C.2.4. Damascus Agreement

The need for air transport liberalization as a precursor to the realization of a greater Arab free trade area was also identified in the Far West. Twenty-two States of the Arab League adopted the Agreement for the Liberalization of Air Transport in 2004 in Damascus, Syria under the Arab Civil Aviation Commission (ACAC). The agreement entered into force in 2007 after being ratified by 8 states: Jordan, Lebanon, Morocco, Oman, Palestine, Syria, Yemen, and the UAE. Particularly, some other key States in the area, Egypt and Saudi Arabia, are not on the list. Both countries may have abstained from ratifying the agreement to protect their domestic market and national airlines from the threat of the neighboring carries.

The Damascus Agreement provides for unlimited Third, Fourth and Fifth freedom rights between points in the territory of the State Parties. For the UAE, the unlimited access under Third and Fourth freedom is tremendously important for the successful expansion of its national carriers, Emirates Airlines and Etihad Airlines (commonly recognized as Gulf carriers). Being strategically located in the intersection of major world's aviation market, these Gulf carriers may conveniently collect the inbound traffic and funnel them for onward destinations through its home hub. This

⁸⁹ Regional Economic Groupings in Africa consists of different association or community within different regional blocks, including: 1) North Africa (the Arab Maghreb Union and the League of Arab States); 2) West Africa (the Economic Community of West African States, the West African Economic and Monetary Union, and the Banjul Accord Group); 3. Central Africa (the Economic and Monetary Community of Central Africa); 4. Southern and East Africa (the Common Market for Eastern and Southern Africa, the Southern African Development Community, and the East African Community).

⁹⁰ Charles Schlumberger. *Open Skies for Africa: Implementing the Yamoussoukro Decision* (Washington DC: The World Bank, 2010) at 15.

typical operation is known as Sixth freedom and, thus, these airlines are renowned as Sixth freedom carriers. This traffic right is not explicitly regulated in most of the air service agreements but practically exists in the field of airline business. Sixth freedom is nothing but a combination of liberal Third and Fourth freedom traffic rights. Moreover, due to the geographical factor, unlimited Fifth freedom would benefit the Gulf Carrier to serve intra-Middle East traffic.⁹¹ Such unique vantages do not apply to all ACAC Members. It is thus plausible that the Damascus Agreement generates low acceptance from other States in the region.

C.2.5. European Union

In contrast to other regional arrangements, the EU open skies encompasses a distinct arrangement with unique legal characteristics by the institutionalization of a supra-national legal order as well as the supremacy of Community laws.⁹² Moreover, the open skies regime in Europe not only manifests in relaxing market access, nationality rules, and other domestic aviation-related laws, but also encapsulates a unitary system of regional aviation market.

Notwithstanding, the open skies movement in Europe also encountered tedious journeys before it became what is now claimed to be the most successful single aviation market. The open skies regime was relentlessly promoted by the Commission and its pro-market allies (notably the UK and the Netherlands),⁹³ but consistently opposed by the Council of Ministers and some conservative EU Members that used to have a majority voice (notably France and Germany)⁹⁴ as well as the airlines represented by the Association of European Airlines (AEA).⁹⁵ As a result, the

⁹¹ Alan Tan, *The Future of Multilateral Liberalization of Air Transport in Asia* in David Timothy Duval (ed.) supra note 3, at 266.

⁹² Jeffrey Goh. *The Single Aviation Market of Australia and New Zealand* (UK: Cavendish Publishing Ltd, 2001), at 42.

⁹³ Britain was in a better position to exploit a single competitive airline market than any other country in the Community because, in addition to its national flag carrier, it also had successful independent and charter airlines to such an extent that other Member States did not have. It had a vast international network thanks to its imperial history and in virtue of being one of the international pioneers of air travel. Moreover, Heathrow used to be the largest international hub in the world and also the gateway to Europe for much of the North American market. On the other hand, the Netherlands were in favor of liberalization because of their interest to develop Schipol and KLM in lieu of the tiny size of their domestic market. See Alan P. Dobson. *Globalization and Regional Integration: The Origins, Development and Impact of the Single European Aviation Market* (New York: Routledge, 2007) at 10-11.

⁹⁴ Many of EU countries were used to be regulatory conservative in governing their civil aviation sectors. This situation was buttressed by a combination of vested interests among dominant national flag carriers, and unsympathetic political ideologies against market reforms such as socialist *dirigisme* in France and social democracy and trade unionism in Germany. Ibid, at 9.

⁹⁵ AEA claimed that imposing liberal policies (like in the US) for the European air transport industry would give detrimental impacts towards the airline business. It criticized the Commission's insistence for liberalization was triggered by a flawed understanding regarding the outcomes of US deregulation, to which they referred as the root

course of liberalization in European countries underwent a gradual and sluggish progress, in which, in its early implementation, brought about less dramatic impacts to the market than those in the US deregulation.⁹⁶

Even so, the European open skies arrangement renders some exceptional breakthroughs in terms of the regulatory framework that worked beyond the common approach. Notably, it abolishes the traditional nationality principle and cabotage restriction, and features *en bloc* negotiation with non EU Countries. This was made viable by two separated-but-corresponding factors: the majority, if not unanimous,⁹⁷ acceptance of the third legislative “package,”⁹⁸ and the supremacy of the European Court of Justice (ECJ) rulings.

The third package of liberalization substantially paved the way to totally liberalize market access, whereby the EU airlines are free to fly to any points within the EU territory (including domestic points) and to determine the frequency and the fares of their services.⁹⁹ Besides eliminating restricted airline designation criteria for community carriers and capacity limitations,

cause of bankruptcies, loss of jobs, abandonment of unprofitable services to smaller communities and a reconsolidation of the industry. Ibid, at 83.

⁹⁶ Some operational changes came about in relation to the use of new routes as a result of unlimited Fifth freedom to fly and the entry of several new small airlines (particularly low-cost-carriers) to scheduled routes. Another consequence was the abandonment of most of the revenue-pooling agreement, which was previously common between European carriers, due to a more stringent policy on pooling agreement after the passing of first package. Nonetheless, neither did significant airfare reduction nor aggressive new entrants or start-up airlines appear in the European market. Apparently, the gradual and sluggish process of European liberalization was likewise responded by the European airlines in a slow and careful way. See Rigas Doganis, *supra* note 10, at 102-106.

⁹⁷ Some recalcitrant EU States like France, Germany, Greece, and Italy attempted to limit and postpone the implementation of the “radical” third package in many ways. To name a few, they suggested to divide the implementation of the single market into two categories: a complete deregulated environment for international routes and a protected environment for domestic routes; made a reservation on stand-alone cabotage (Ninth freedom); and proposed to regulate the access to routes within their national territory. The Council of Ministers barely granted all of these demands. Rather, the Council allowed for a longer transitional period until 1977 before the full implementation of cabotage and provided some safeguarding clauses alongside the restrictive provisions (for examples in determining route and pricing). Such bargains eventually culminated with a full acceptance of the third package. Martin Staniland, *supra* note 13, at 96-99.

⁹⁸ Three aviation policy packages have substantially transformed the European air transport industry from a protected and state-centric regime under the bilateral air transport agreements to a liberal and market-driven regime under multilateral framework. First Package (1987) reduced fare restrictions and accorded an additional flexibility for the carriers to cooperate within the limits of existing air service agreements. Second Package (1990) granted unlimited Third, Fourth and Fifth freedoms and abolished fare and capacity restrictions. Third Package (1992) provided common licensing and freedom of access to the market for all EU carriers. The carriers with a community license were allowed to serve any international route within the European Union, granted full freedom to set fares (subject to the safeguards against unfair pricing), and granted the right of cabotage in 1997. The last package is the most important one as it radically liberalized the fare setting system and abolished the nationality clause. In addition to the full freedom to set fares and capacity, all EU carriers holding a community license had access to operate domestic routes within the whole of the Community territories from 1997 onwards. Ibid.

⁹⁹ Ibid, at 96.

the adoption of third package by the Council outlawed double disapproval system for pricing. The freedom to set the ticket price, however, must take into account the interests of consumers and industry as regulated in the Council Regulation 2409/92.¹⁰⁰ It is important to note that those regulatory freedoms and unlimited access to the domestic aviation market for the European airlines under the third package was not applicable to services to and from Third countries outside the community. In this regard, bilateral air transport agreement between the Third Party and the respective EU Members was the only possible means for the outsiders to tap into the EU internal market. Under this circumstance, any EU airline would potentially be treated differently by the third countries in accordance with the relevant bilateral agreement agreed by its respective government and that Non-Community State.

For example, after 1997, Air France could fly the Gatwick-Amsterdam route from Lisbon with the same privileges as granted to British and Dutch carriers, but not necessarily operate the Gatwick-Amsterdam-Sydney route (although KLM could), unless the French government had concluded a bilateral agreement with the Australian government specifying the rights to do so. As another example, the Australian government might allow any French airline to offer air passenger service under Third and Fourth freedom by aircraft with a maximum of 150 seats, while it might allow any Dutch airline to serve the same route with unlimited Fifth freedom. This imbalanced treatment, according to the Commission, was in contrast to the EU single market priority and, thus, must be taken into account seriously by instituting an en bloc negotiation.¹⁰¹

At times, the EU Countries and the Council of Ministers were hardly convinced by the Commission's recommendations. In this situation, the latter aspect, the supremacy of the ECJ's rulings, became crucially important to achieve a 'satisfactory' level of European integration as envisaged by the Commission. A number of decisions made by the ECJ did not only confirm the status of liberalizing commercial aviation under the ambit of Treaty of Rome,¹⁰² but also

¹⁰⁰ COUNCIL REGULATION (EEC) No 2409/92 of 23 July 1992 on fares and rates for air services Art 6.

¹⁰¹ The Commission aimed the creation of the single market to establish a cabotage area in Europe. Martin Staniland, *supra* note 13, at 135.

¹⁰² The ruling by the ECJ under the French Merchant Seamen case in 1974 extended the breadth of Treaty Rome to include the air transport industry. The treaty contains three fundamental provisions: Art 2 (proclaiming the intention to establish a common market), Art 3(e) (the adoption of a common transport industry), and Art 3(f) (requiring an institution to ensure the non-distortion of competition in the common market). *Ibid*

significantly catalyzed the endeavors to establish a so-called “cohesive unitary system”¹⁰³ in Europe.¹⁰⁴ Such endeavors culminated in 2002 when the ECJ pronounced its judgment in relation to the EU-Third Party air service agreements.¹⁰⁵ The Court firmly held that the “substantial ownership and effective control” provisions violate the right of establishment guaranteed under Article 43 of the Treaty of Rome.¹⁰⁶ Consequently, the bilateral agreements that conferred nationality clause only to respective EU States were rendered illegal under the EU law¹⁰⁷ and, furthermore, such agreements that dealt with Computer Reservation Systems (CRSs), fares, rates and slots were also illegal as the Community had assumed competence over those areas.¹⁰⁸ Of great importance, the Court pronounced that external civil aviation relations are not under exclusive competence of the Commission, but instead, under a shared competence between the Commission and the Member States. Although the decision remained ambiguous as to what action to be done against these “unlawful” bilaterals, this made it clear that EU Member State may continue to conclude open skies agreement with Non-EU Countries as they were, so long all EU carriers got similar access to such routes.

In effect, the EU Member States must work closely with the Commission to enter into bilateral air service agreements. In June 2003, the Commission finally obtained a full negotiating mandate from the Council, which became known as the “horizontal mandate”, to open talks with all third countries involved in bilaterals with Member States.¹⁰⁹ In April 2004, Regulation 847/2004 was

¹⁰³ Brian F. Havel. *In Search of Open Skies: Law and Policy for A New Era In International Aviation: A Comparative Study of Airline Deregulation In the United States and the European Union* (The Hague ; Boston : Kluwer Law International, 1997) at 336.

¹⁰⁴ The ECJ’s decision on the *Nouvelles Frontières* case in 1986 determined that the EC competition law was applicable to air transport that had previously been treated as an exempted sector. This decision significantly brought fresh air on behalf of the proponents of liberalization. See *Ibid*, at 293-300.

¹⁰⁵ The case was filed in 1988 by the Commission against 7 EU States, which entered into bilateral open skies agreement with the United States (Austria, Belgium, Denmark, Finland, Belgium, Denmark, Finland Germany, Luxembourg, and Germany) and the United Kingdom which signed a restrictive bilateral (Bilateral II) that included an “effective ownership and control” clause. See *Commission of the European Communities c. Republic of Austria*, ECJ (Nov. 5, 2002) et al, Cases C-466/98, 467/98, 468/98, 469/98, 471/98, 472/98, 475/98, and 476/98.

¹⁰⁶ Paul S. Dempsey, *supra* note 14, at 573.

¹⁰⁷ The nationality clauses were illegal as they prevented any European airline, which was neither owned nor controlled by the EU Members, to benefit from the Community’s establishment rules. Alan P. Dobson, *supra* note 93, at 175.

¹⁰⁸ *Ibid*.

¹⁰⁹ The mandate was based on the proposals made by the Commission to the Council in November 2002 and in February 2003. The first proposal consisted of three key issues: 1) affirming the shared competence between the Commission and the EU Member States; 2) affirming the illegality of the bilaterals under the ECJ’s decision and instructing the Member States to refrain from making any agreement that is in contrary to the Community policy; and 3) affirming the EU relationship with the US. The second proposal reiterated similar problems in more detailed fashion. It addressed the importance of the transparency that would allow all the Member States and the Community’s institutions to be aware of how negotiations were progressing and for appropriate procedures to ensure effective

promulgated on the negotiation and implementation of ASAs with third countries. It established a legal framework, within which the Member States could continue to negotiate bilateral agreements and adjust existing ones. Their bilaterals, however, must conform to Community laws and be communicated to the Commission.

Therefore, the integration of the air transport market in Europe has been perceived to facilitate the producers (airlines) free market environment to supply their services without discrimination throughout the Community. This clearly cannot be done if airlines are restricted by existing bilaterals as to the Community airports from which they can operate international services to points outside the Community. To overcome this problem, the Commission is pursuing two parallel lines of action. First, it is making it possible for Community airlines to establish themselves in and operate from other Community states. It has to do with the nationality requirement and the intra-regional freedom traffic. Second, the Community engages in *en bloc* negotiation.¹¹⁰ This way, any EU airlines will now have equal treatment in intra-regional open skies agreements.

Furthermore, 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.

D. Conclusion

Regional open skies arrangements present unique challenges. Only a few regional open skies agreements have led to substantial liberalization or integration. In fact, being in a close proximity or having comparable market size and economic development may not assure the implementation of the open skies agreement. The problems envisaged in a regional arrangement are somehow more complex than those in the bilateral structure. Bearing in mind that the former involves a bigger number of contracting parties, thus, there might be more competing interests at stake. For example, the EU Single Aviation Market needs decades to put the platform of the single market under the relentless efforts of the European Commission and the decisions made by the ECJ. Meanwhile,

implementation. See COM(2002)649, Final, 'Communication from the Commission on the consequences of the Court judgments of 5 November for the European air transport policy', 19 November 2002 at 6 and COM(2003)94, Final, 'Communication from the Commission on relations between the Community and third countries in the field of air transport', 26 February 2003 at 5.

¹¹⁰ Richard Doganis, *supra* note 10, at 91.

some others regions are still struggling to cope against the disparate level of national development among their members that consequently slows down the process to regional liberalization.

After examining some of the regional open skies agreements from different world geographies, we learn that an instant or “big bang” approach to deregulation is not a good model to follow. Instead, there has to be a transitional period from a fully regulated and protected market to a fully liberalized environment.

Jagdish N. Seth et al, who studied the deregulation effects on major airlines in the United States, Europe, India and Southeast Asia, assert that:

“For the incumbent airlines, it is not reasonable to expect that overnight there will be a 180 degree switch from being a competition-sheltered organization with protected routes, regulated pricing, and lack of meaningful competition to being a savvy marketing strategy and customer oriented organization that deftly fights off swarms of low-cost start-up airlines.”¹¹¹

A staged process does not necessarily mean a machination to protect certain airlines. Instead, it may provide an opportunity to adjust from an industry structure that was mandated by the government to a new regulatory vision. Moreover, this helps to minimize the interruptions and uncertainty for the consumers of the airline industry. If the market is opened too quickly, as history shows, some difficulties would likely beat the incumbents, which, more often than not, are national carriers. The ensuing chaos and possibility of collapse of the incumbents creates undue hardships and can even result in a political backlash against liberalization. Thus, it is important that regulators develop a strategy for a staged liberalization that provides incumbents with a measured timetable for the transition. This measure will allow incumbents to reorient their organizations to face a new world of competition and benefit from less disruptive process of liberalization.¹¹²

Furthermore, as what we have learned from the EU Single Aviation Market, any effort to create a complete single aviation market would require an enormous amount of political will and commitment to harmonize, and eliminate differences in, the laws, policies and practices between the States wanting to become the parties.

¹¹¹ Jagdish N. Seth, et al., *Deregulation and Competition: Lessons from the Airlines Industry* (New Delhi: Vivek Mehra, 2008) at 293.

¹¹² Ibid, at 294-295.

CHAPTER II

OPEN SKIES REGIME IN SOUTHEAST ASIA

Regional economic integration has become very important for the ten Members of the Association of South-East Asian Nations (ASEAN).¹¹³ Collectively, the region is a major global hub for international trade¹¹⁴ and has become one of the largest economic regions in the world.¹¹⁵ The combination of a robust population and increased purchasing power has made the region one of the world's fastest-growing consumer markets. With its strategic location, abundant natural and human resources, and growing economies, ASEAN proceeds to a regional economic cooperation under the auspice of the ASEAN Economic Community (AEC). Together, ASEAN countries are prospecting a stronger and bigger market as well as a louder political voice at international negotiation table.

Air transport is one of the main priority sectors in this integration process. Being archipelagic in nature, the region has a sizable distance between capital cities but limited cross-border land links.¹¹⁶ Its unique spatial condition becomes the region's vantage point to enable it benefit from tourism, which has emerged not only as the leading source of the countries' income,¹¹⁷ but also as

¹¹³ The name of *Southeast Asia* was adopted and gradually came to prevail to define the peninsulas between India and China, as well as the Indonesian and Philippine archipelagos. Historically, this geographical region acquired international attention during the World War II, when the Western had a concern of the military invasion by the Japanese in the said area. On 8th August 1967, five States from this region (Indonesia, Malaysia, Singapore, Philippines, and Thailand) agreed to establish a regional cooperation on the basis of economic, cultural, social and political interests, so-called ASEAN. After its establishment, five other countries from the same region (i.e. Brunei Darussalam, Myanmar, Cambodia, Laos, and Vietnam) gradually joined the association. See Thomas R. Leinbach and Richard Ulack, *supra* note 7, at 3.

¹¹⁴ Southeast Asia is located in the crossroad, over and through which trade and the movement of peoples, ideas, and innovations passed. In addition, Southeast Asia is located between India and China, two areas with huge populations and distinct cultural characteristics. See *Ibid*.

¹¹⁵ The data published by McKinsey stated that in 2013, ASEAN collectively ranks the seventh largest economy in the world, after the United States, China, Japan, Germany, France, and United Kingdom. See McKinsey&Company, *Understanding ASEAN: Seven Things You Need to Know* (2014) online: <www.mckinsey.com/industries/public-sector/our-insights/understanding-asean-seven-things-you-need-to-know>. In 2015, ASEAN's economic is in the sixth place in the world (outpacing France and India), and in the third place in Asia with an average annual real growth rate of 5.2%.

ASEAN Secretariat. "ASEAN Economic Community At A Glance 2007-2015 (2016) online: <asean.org/storage/2015/11/AECat-a-glance-2016_web_version2.pdf>.

¹¹⁶ ASEAN's land area extends to 4.4 million square km or approximately 3% of the total land area of Earth. Moreover, ASEAN territorial waters cover an area about three times larger than its land territory. Fidel V. Ramos, "ASEAN at 50: Philippines in the lead" (2017) online: < <https://www.pressreader.com/philippines/manila-bulletin/20170122/281754154030428>>

¹¹⁷ Tourism industry becomes the leading source of foreign exchange in Thailand, the second largest industry in the Philippines and the third largest earner of foreign currency in Singapore. See Jim Newton, *Floating Market: Currency Crises and ASEAN Tourism Exports* in Roger Strange, et.al (ed.). *The European Union and ASEAN: Trade and Investment Issues* (UK: Palgrave Macmillan, 2000), at 163

a potential means of development for the less-developed members, such as Cambodia, Laos, and Myanmar.¹¹⁸ These are some of the major reasons behind the region's heavy reliance on the aviation industry. Notably, improved connectivity through air transport links is an essential component of economic growth, as it provides personal access to the region as well as physical access to resources and markets. With respect to the tourism industry, air services facilitate the tourist arrivals and the (flag) air carriers promote the countries as tourist destinations.¹¹⁹

ASEAN Open Skies Agreements (AOSAs) emphasize the commitment of the ASEAN States on establishing closer cooperation in the air transport industry. This arrangement is originally meant to be a stepping stone towards ASEAN's ambitious future plan, namely the ASEAN Single Aviation Market (ASEAN SAM). This liberalization scheme is somewhat controversial due to the deep-rooted protectionist behavior that characterizes the market ideology of most of its Members. Problems also exist in terms of the disparate levels of economic development and political turbulence among them, which raises questions regarding their readiness to perform together as a market union. Moreover, the pessimistic reaction upon successful implementation of the open skies arrangement is more conspicuous after the failure to enforce the AOSA in a timely manner.¹²⁰

A. The Overview of the Air Transport Industry in ASEAN

Tourism accounts for the largest share of the intra-ASEAN economy. For ASEAN citizens, Malaysia is the most important regional leisure destination, followed by Singapore and Thailand. Meanwhile, a high proportion of Philippines tourist arrivals come from outside the region.¹²¹ Singapore is a popular stopover *en route* from Europe to East Asia and Australasia, and a major international tourist destination. The significant number of outbound tourists brings high incomes for the Singaporeans. On the other hand, the small size of Singapore Island, its high population density and high per capita income encourage Singaporeans to travel abroad.¹²² Similarly,

¹¹⁸ Brian Graham, *supra* note 8, at 204.

¹¹⁹ The joint promotion of tourism with Singapore Airlines was the principal motivation behind the Singaporean government's negotiation of its open skies bilateral with the US. Also, the improvement of tourist arrivals in Thailand is purportedly benefited from a largely "open skies" policy adopted in 1989. *Ibid.*, at 207.

¹²⁰ Cambodia, the Lao PDR, and Indonesia had not ratified the MAFLPAS after the deadline elapsed. On top of that, Philippines still excluded its major airport, Ninoy Aquino International Airport, from the Agreement.

¹²¹ Keith Trace, Barend Frielink, and Denis Hew. "Air Connectivity in Archipelagic Southeast Asia: An Overview" ADB: Southeast Asia Working Papers (2009) online: <<http://hdl.handle.net/11540/1398>> at 6.

¹²² *Ibid* at 5.

Malaysia is also an important tourist and business destination and relatively large numbers of Malaysian students study abroad.¹²³

The ASEAN Secretariat revealed that the most important factor in the success of developing tourism sector in the region is the number of flight frequency. The more frequencies are offered, the more opportunities the tourists may have to travel to, from, and within ASEAN countries. It offers an easy accessibility for air connectivity with more choices, time efficient, and cost effective.¹²⁴

Often, both passenger and freight traffic flowing between Southeast Asia and the rest of the world is funneled through either Bangkok or Singapore. Singapore and Bangkok are also major transit hubs for long-haul inter-regional traffic. Singapore itself is an important stopover on the “kangaroo route” between Europe and Australia. In the 1990s, Singapore received more international air traffic than its rival, Thailand, but this circumstance may change in the future. The Thai capital is better positioned to serve as a gateway to Burma, Laos, Cambodia, and Vietnam. Bangkok also enjoys a superior location to China and India, the two economic giants in Asia.¹²⁵

The Singapore international airport, Changi, has been internationally recognized as one of the best airports in the world.¹²⁶ Nevertheless, despite Changi’s long-standing competitiveness, Kuala Lumpur International Airport (KLIA) is catching up. In 2007, the Airports Council International (ACI) Airport Service Quality Awards nominated KLIA as the best for the 15–25 million passengers category.¹²⁷ Malaysia has invested substantially in overall infrastructure development, including its airports, in its pursuit of economic development. The Malaysian government has built a sprawling new airport in Sepang. The new facility has an annual capacity of 25 million passengers, about twice the capacity of Kuala Lumpur’s previous airport. This overall focus on total infrastructure development places Malaysia well ahead of most of its regional neighbors on the competitive ladder, with the exception of Singapore.¹²⁸

¹²³ Ibid.

¹²⁴ *Open Skies in ASEAN: ASEAN Expert Links Tourism Growth to Air Access and Flight Frequency* (2016) online: <www.balidiscovery.com/messages/message.asp?Id=14135> .

¹²⁵ Thomas R. Leinbach and Richard Ulack, *supra* note 7, at 238.

¹²⁶ Tham Siew Yean, in Douglas H. Brooks & Susan F. Stone, *Trade Facilitation and Regional Cooperation in Asia* (UK: Edward Elgar Publishing Limited, 2010) at 46.

¹²⁷ Ibid.

¹²⁸ Ibid, at 52.

Jakarta and Manila are less important as regional hubs due to their geographic locations, which are relatively distant from the region's core, and their proximity to much larger hubs. Jakarta is firmly the shadow of Singapore, while Manila is dominated by nearby Hong Kong and Taipei. Consequently, Manila and Jakarta receive significantly fewer international flights per week than Singapore, Bangkok, and Kuala Lumpur.¹²⁹

The seat capacity on flights within and from Southeast Asia increased 13 percent in 2013 compared to 2012. The biggest improvement was made by Indonesia Air Asia and Nok Air with a 58.4% and 49.4% seat capacity increase respectively. However, the biggest intra-ASEAN market share was captured by Lion Air with 13%, followed by Air Asia and Garuda Indonesia, both with approximately 7%. As for the airport rank, Singapore International Airport (Changi Airport) made up the number one in scheduled air capacity within and from Southeast Asia, with a slight higher share than Indonesian International Airport Soekarno-Hatta (CGK). Each dominated more than 10% of the seat capacity share in 2013, closely followed by the airports in Bangkok, Kuala Lumpur, and Manila.¹³⁰

Notably, the strong growth in the ASEAN's aviation industry is influenced by the proliferation of Low Cost Carrier (LCC). LCC account for two-thirds of all regional seat capacity with no less than six-hundred aircraft.¹³¹ There are currently more than 20 low-cost carriers operating in the region whose fleets have expanded by more than 50 percent within the past three years.¹³² The burgeoning demand for no-frills carriers marks ASEAN as the only region in the world that has as many aircrafts on order as its active fleet.¹³³ This demonstrates the substantial demand for budget-friendly travel options, and the potential to grow even further.

¹²⁹ Thomas R. Leinbach & Richard Ulack, *supra* note 7, at 239.

¹³⁰ Richard Maslen, "Air Transport Capacity in Southeast Asia - A market Snapshot" (2014) online: <www.routesonline.com/news/29/breaking-news/238853/air-transport-capacity-in-south-east-asia-a-market-snapshot/>.

¹³¹ Jennifer Meszaros, "The Rise and Rise of the Region's Low-Cost Airlines" (2016) online: <sea-globe.com/low-cost-airlines-southeast-asia/>.

¹³² Boeing, "Long Term Market: Current Market Outlook 2016-2035" online: <www.boeing.com/commercial/market/long-term-market/world-regions/> .

¹³³ In 2011, the Malaysian owned LCC, AirAsia, inked an US\$18-billion contract with Airbus for the purchase of 200 A320 NWO jets. The similar action by Lion Air, the fastest growing budget airline in Indonesia, ordering 230 Boeing planes amounting to US\$21 billion. Additionally, Lion Air also signed a contract with Airbus for the acquisition of 234 A320 aircrafts worth 18.4 billion Euro. Philippine Airlines, Thai Airways, Lao Airlines, and VietJet Air also joined the race. In August 2012, Philippine Airlines entered into a US\$ 7-billion contract for the purchase of 54 Airbus planes, and recently, announced the plan to buy additional aircrafts from Boeing. Lao Airlines invested US\$ 47 million for two ATR 72-600 aircrafts. Meanwhile, Thai Airways were also in the line for Boeing's dreamliner jets. "Air Travel, There is No Way But Up" online: <investasean.asean.org/index.php/page/view/air-travel>

LCC has experienced a rapid expansion for the last decade, with AirAsia as the world's most successful LCC group. In 2013, LCCs capture over 50% of the short-haul market, having steadily increased from less than 5% in 2003.¹³⁴ AirAsia's Malaysian subsidiary has consistently had the highest operating profit margin among LCCs in Asia, and is one of the highest globally.

After its long dominant position in the Malaysian short-haul market, AirAsia now has to compete with Malindo Air, a Malaysian-based-no-frills airline resulting from a joint venture between Indonesia Lion Air and a Malaysian company, National Aerospace & Defence Industries Sdn Bhd. Since its first operation on 1 May 2013, Malindo Air has been serving 40 cities in 12 countries, including 13 major airports in Malaysia. Malindo further expanded its networks by entering into an interline agreement with Qatar Airways¹³⁵ and Turkish Airlines.¹³⁶

Indonesian LCCs also experience a rapid growth, led by Lion Air and Indonesia AirAsia. Both budget carriers dominate Indonesia's extensive domestic market, yet the latter has greater capacity and operations as part of the AirAsia Group. Lion Air would likely defeat AirAsia by establishing Thai Lion Air and a joint operation with a Vietnamese partner.¹³⁷ Similarly, Thailand's market also faces an intense competition, where its national LCC, Nok Air, has to compete with two joint-venture companies, Thai AirAsia and Thai Lion.

In contrast, Singapore and the Philippines have shrunk their LCC capacity to restore the airline profitability. As a country that has zero domestic market, Singapore needs to maintain the market share between its expanding LCCs (Jetstar Asia/Valuair, Tigerair Singapore, Scoot) and its aggressive flag carrier, Singapore Airline. While the LCC penetration in the Philippines is high, many Filipino LCCs suffered losses due to stiff competition on some routes. To deal with this issue, some airlines decided to consolidate.¹³⁸ Currently, there are three LCC players remaining in the Philippines market: AirAsia, TigerAir Philippines, and Cebu Pacific.

¹³⁴ CAPA, "Competition in Southeast Asia's low-cost airline sector heats up as capacity surges" (2013) online: <centreforaviation.com/analysis/competition-in-southeast-asias-low-cost-airline-sector-heats-up-as-capacity-surges-126798>.

¹³⁵ "Qatar Airways inks new interline partnership with Malindo Air" (2016) online: <www.themalaymailonline.com/travel/article/qatar-airways-inks-new-interline-partnership-with-malindo-air#sthash.SokzOdEO.dpuf>.

¹³⁶ "Malindo, Turkish Airlines team up to tap new markets" (2016) online: <www.thestar.com.my/business/business-news/2016/06/17/malindo-turkish-airlines-team-up-to-tap-new-markets/#HZCQj0xUdz3xAprv.99>.

¹³⁷ "Lion Air to launch franchise in Vietnam next year" (2016) online: <www.thejakartapost.com/news/2016/11/15/lion-air-to-launch-franchise-in-vietnam-next-year.html>.

¹³⁸ Consolidation came in early 2013 as AirPhil Express rebranded as PAL Express and in the process transitioned to a regional full-service model. AirAsia Philippines also entered into a partnership and cross-ownership deal with Zest,

Of the five smaller markets in ASEAN, Myanmar and Vietnam are the most dynamic from an LCC perspective. VietJet, an independent Vietnam LCC, has already surpassed Jetstar Pacific as Vietnam's largest LCC. In contrast to Vietnam, Myanmar has 11 airlines, signaling the country's potential but also the immaturity of its market. As ASEAN's aviation industry continues to liberalize, there will be increasing opportunities for consolidation in Myanmar and other countries grappling with fiercer competition.¹³⁹

Three much smaller Southeast Asian countries (i.e., Brunei, Cambodia and Laos), have LCC penetration rates below 20% as they lack local LCCs. The Cambodian and Lao markets are both growing rapidly from very small bases, led by a surge in capacity by their flag carriers. Since their markets are too small to support a home-grown LCC, there has to be some expansion to allow their LCC to penetrate larger territories.

LCC has revolutionized the traveling life-style for the Asian. The proliferation of the LCC business model in the region has transformed the market by reducing socio-economic demand barriers, allowing for more affordable fares to a wider range of the population. The growth of low-cost carriers will introduce competition to existing routes whose growth has been inhibited by full-service airlines seeking to maintain high yields. Greater competition will also encourage both LCC and incumbent airlines to develop new routes, notably those linking secondary hubs. In the medium-to-long term, these trends will substantially improve air connectivity in the ASEAN region.¹⁴⁰

B. ASEAN as A Regional Economic Block in the Global South: The Birth of ASEAN and How It Works

On the eighth day of August 1967, the Association of South-East Asian Nations (ASEAN) was officially established.¹⁴¹ ASEAN initially represented five States situated in the south-eastern

which gives AirAsia access to the Manila market. Zest flights are now available on the AirAsia website and the carriers are in the process of integrating further, culminating in Zest adopting the AirAsia brand.

¹³⁹ Alexander Chipman Koty, "The State of ASEAN Aviation in 2016" (2016) online: <www.aseanbriefing.com/news/2016/05/06/asean-aviation-2016.html>.

¹⁴⁰ Keith Trace, *supra* note 121, at 13.

¹⁴¹ The ASEAN acronym was casted by the Indonesian minister of foreign affairs, Mr. Adam Malik. Thanat Koman, the foreign minister of Thailand, initiated an association in Southeast Asia to intermediate the dispute between the Philippines, Malaysia, and Indonesia. Thailand was the country with the relentless endeavours to take a conciliatory role between regional countries through mediation, talks, negotiations, and join forces. The ASEAN acronym was casted by the Indonesian minister of foreign affairs, Mr. Adam Malik.

Asian peninsula sharing a common understanding in the importance of regional partnership over some similar existing arrangements.¹⁴² Through some sort of “sport-shirts diplomacies”,¹⁴³ the representatives of Indonesia, Thailand, Malaysia, Philippines, and Singapore discussed the possibilities to emerge in the international fora as a block.¹⁴⁴ After several failed attempts to build a similar kind of regional cooperation,¹⁴⁵ ASEAN was eventually established with the signing of the Bangkok Declaration.

Over time, ASEAN expanded its membership from five to ten States.¹⁴⁶ The group currently contains 10 countries, i.e. Brunei Darussalam, Burma, Cambodia, Indonesia, Malaysia, Laos, the Philippines, Thailand, Singapore, and Vietnam. It displays a wide range of development settings and conditions both between and within States. These range from the chaos and isolation prompted by political forces in Burma, Laos, and Cambodia, to the economic renewal (*doi moi*) in Vietnam, to the high level of technological and trade-driven economic development in Singapore.¹⁴⁷ In addition, many intra-ASEAN disputes have yet to come to an end. The sovereignty issue between the Philippines and Malaysia over Sabah, the territorial dispute between Indonesia and Malaysia over Ambalat strait, the maritime dispute over the South China Sea, and Indonesian-Singaporean dispute over territorial airspace in Riau Island are but a few internal disputes that remain unresolved.

As stated in the Bangkok Declaration, the primary objective of ASEAN is to accelerate the economic growth, social progress and cultural development in the region through joint endeavors

¹⁴² An example of this similar arrangement is the European Community. EC underwent a constant expansion in terms of membership by the addition of former European Free Trade Area (EFTA) Members as well as a number of Central and East European countries. Another example, NAFTA (the North American Free Trade Area) is parallel to another one further south of the American continent. Likewise, on the southeast wing of Europe, Turkey is busy organizing some form of co-operation with the Islamic states of the Black Sea region of the defunct Soviet Union.

¹⁴³ The talks were conducted during the golf course, and in the resort beach in Bangkok.

¹⁴⁴ The new organization was planned to comprise only the former ASA members plus Indonesia. Singapore was later interested in becoming the member and its application was considered.

¹⁴⁵ The first organization for regional co-operation in Southeast Asia was ASA (Association of Southeast Asia) in 1961, comprising of Malaysia, the Philippines, and Thailand. However, the ASA was paralyzed by the dispute in Sabah between Malaysia and the Philippines. The efforts continued to be made in Bangkok for the creation of another organization. In 1966 a larger grouping, combining former ASA countries with East Asian nations such as Japan, South Korea, Australia, Taiwan, New Zealand, South Vietnam and Thailand, was established and known as ASPAC (Asian and Pacific Council). However ASPAC was folded up in 1975 due to the vagaries of international politics. The admission of the People's Republic of China and the eviction of the Republic of China or Taiwan made it impossible for some of the Council's members to sit at the same conference table.

¹⁴⁶ The latter countries join the ASEAN, i.e. Brunei Darussalam then joined on 7 January 1984, Viet Nam on 28 July 1995, Lao PDR and Myanmar on 23 July 1997, and Cambodia on 30 April 1999

¹⁴⁷ Thomas R. Leinbach and Richard Ulack, *supra* note 7, at 1.

in the spirit of equality and partnership. Rather than using the military approach, ASEAN focuses on achieving peace and stability through abiding respect for justice and the rule of law.

ASEAN works under the framework of the ASEAN Charter that also confers the association's legal personality.¹⁴⁸ The charter also codifies the ASEAN norms, rules and values, sets clear targets for ASEAN, and assumes accountability and compliance. The ASEAN Summit is the supreme policy-making body in ASEAN, comprising of Head of States or Head of Government of the ASEAN Members. ASEAN is chaired by one of the ASEAN States that is rotated annually and is responsible to lead the ASEAN Summit and related summits, the ASEAN Coordinating Council, the three ASEAN Community Councils, relevant ASEAN Sectoral Ministerial Bodies and senior officials, and the Committee of Permanent Representatives.¹⁴⁹

According to Hadi Soesastro, when it was established in 1967, ASEAN did not set the ambitious task of becoming a regional organization with complex institutional structures and machinery for itself.¹⁵⁰ Economic co-operation was not, after all, the real objective of the formation of ASEAN. At the beginning, the association was directed simply as a means of strengthening political unity. Economic cooperation was largely considered only when the need arose. It was used as a policy instrument for economic recovery at the time of economic stagnation during 1980-1986 and then relatively ignored when the economy was recovering. It was again adopted as a policy instrument as a result of external forces after that. Later, economic cooperation was discussed as a policy instrument in 1992 when the challenge and threat of global trade liberalization were felt. Until recently, ASEAN economic co-operation has continued to be determined by political rather than market forces.¹⁵¹

C. Liberalization of Air Transport in Southeast Asia

John Bowen and Leinbach have identified several factors that affected the liberalization in Southeast Asia. Primarily, air traffic in ASEAN has experienced a fast growth, notably since the late 1980s. To develop and maintain the *status quo*, there was a need to minimize restrictive

¹⁴⁸ Art 3 of ASEAN Charter.

¹⁴⁹ Art 31 of ASEAN Charter.

¹⁵⁰ Hadi Soesastro, "ASEAN in 2030: The Long View" in Simon S.C. Tay, Jesus P. Estanislao, Hadi Soesastro (eds.), *Reinventing ASEAN*, (Singapore: Institute of Southeast Asian Studies, 2001) at 277.

¹⁵¹ Narongchai Akrasanee, "ASEAN in the Past Thirty-Three Years: Lessons for Economic Co-operation in Reinventing ASEAN", in *Ibid*, at 40-41.

regulatory control in the airline industry. Moreover, the rapid increase for air travel is also expanding to the secondary destinations. Consequently, the barriers to entering the airline industry should be eased to invite more players to serve peripheral cities, such as Surabaya and Denpasar in Indonesia, Penang in Malaysia, and Cebu in the Philippines. Furthermore, the ASEAN Members have different national development priorities. On the one hand, the priorities reflected in the aviation policy can provide a favorable environment for liberalization, especially when the government has a strong tendency to boost the trade and tourism sectors. For example, in Malaysia and Thailand, new domestic carriers were formed to pioneer routes to serve new tourist destinations. On the other hand, the development priorities can inhibit the liberalization process as there is a tendency to protect internal market and incumbent airlines. In this sense, the policy adopted usually confers a protectionist and monopolistic approach. The development level will affect the degree of liberalization implemented. As less developed Members commonly have more limited resources, it would be hard for them to achieve the same extent of liberalization as that implemented by the more developed Members. Finally, the role of ethnic politics greatly influences market liberalization. This is unique for every country, depending on the regime in power. For instance, Indonesia had been governed under two different orders in two different eras: the old and new order era. The former took a nationalistic ideology and the latter adopted a neo-liberal view. As a result, airline business in the new order era under President Soeharto evolved significantly compared to the old order under President Soekarno's regime.¹⁵²

In an industry in which each domestic market is overwhelmingly dominated by a small number of firms, exposure to international trade may be the best means to rapidly increase the level of competition.¹⁵³ Based on this perspective, it is important for ASEAN Members to adopt policies that allow for greater competition in the market. Moreover, the need for a coherent air travel infrastructure system and the increasing demand for low cost travel are the main drivers for the adoption of open skies policy in ASEAN.¹⁵⁴

The process of air transport liberalization among the ASEAN Members can be explained in three interconnected aspects: unilateral, sub-regional, and regional.

¹⁵² John T. Bowen Jr. & Thomas R. Leinbach, *supra* note 70, at 84-85.

¹⁵³ *Ibid.*

¹⁵⁴ Sri Nurhendiarni, Nila K. Hidayat & Linus Pasasa. "The Effect of ASEAN Open Skies Policy 2015 upon Opportunities for LCC in Indonesia – A Case Study of PT. Citilink" (2015) 1, 9 SEAM 34, at 35.

C.1. Unilateral liberalization

In the aftermath of World War II, each of the newly independent States in Southeast Asia established its own state-owned airline. Malaysia Airlines (MAS),¹⁵⁵ Singapore Airlines (SIA),¹⁵⁶ Garuda Indonesia Airways (GIA),¹⁵⁷ Philippine Airlines (PAL),¹⁵⁸ Thai Airways International (THAI),¹⁵⁹ Vietnam Airlines (HVN)¹⁶⁰ were initially formed as carriers under the majority of government ownership and control. Apart from SIA, these flag carriers used to enjoy an overwhelming dominance in their home countries with lucrative domestic trunk routes and favorable market regulation.

SIA and MAS were the first ones to be privatized. In 1985, the shares in both carriers were sold to private investors, while the respective States held on to no less than 50% of the controlling interests. In February 1994, the Malaysian federal government sold most of its remaining stake to a wealthy Malaysian entrepreneur due to MAS's poor financial performance. Subsequently, the private control helped reinvigorate the airline, spark an overhaul of its strategy, and make it more competitive in the global airline industry.¹⁶¹

Frustration was also one of the primary reasons behind the privatization of Philippine Airlines (PAL). In 1992, the Philippine government surrendered 67% of PAL to the PR Holdings consortium. Nevertheless, the government still held 33 percent directly and another 13 percent indirectly as a stakeholder in PR Holdings, meaning that it still had an influential power in the airline company.¹⁶² In the same year, Thai government began to privatize the Thai International through a lengthy process that led to an incomplete privatization, of which a 93% share remained

¹⁵⁵ It is formally known as Malaysian Airline System Berhad (MAS). It was founded in 1972 as a state-owned carrier after the breakup of Malaysia-Singapore Airline.

¹⁵⁶ Singapore Airline has a longstanding participation in the international market and is known as the best and most successful carrier in the world. It was founded in 1972 as fully owned by the Singaporean government after the breakup of Malaysia-Singapore Airline.

¹⁵⁷ Garuda Indonesia Airways was founded in 1950 as a state-owned carrier. It was formed as a legacy of KLM Royal Dutch *Interinsulair Bedrijf* that provided inter-island services. Among the other ASEAN carriers, Garuda has the longest ownership transition history.

¹⁵⁸ Philippine Airlines was formed as a private carrier by a Filipino industrialist in 1941 and then nationalized in 1977.

¹⁵⁹ In 1947, Thai Airways was formed by the state. Twelve years later, Scandinavian Airlines System acquired 30% stake of the company. In 1977, the Thai government regained the whole ownership.

¹⁶⁰ Vietnam Airlines was initially formed as Air Vietnam in 1951 with a two-third government ownership and a one-third Air France's. In the subsequent years, it became a fully state-owned carrier.

¹⁶¹ Thomas R. Leinbach & Richard Ulack, *supra* note 7, at 240.

¹⁶² John T. Bowen Jr. And Thomas R. Leinbach, *supra* note 70, at 86.

under governmental control.¹⁶³ Meanwhile, Indonesia embraces liberalization through deregulation rather than privatization. As we will see further deeply in Chapter III, the Indonesian government had amended numerous air transport regulations to meet the market condition and consumer demand. Although GIA was still the price leader, such amendments had increased the number of private-owned airlines, which, in turn, intensified the competition with the flag carrier and even other modes of transportation.¹⁶⁴

However, Singapore is different. This tiny island-State has concluded more than 40 open skies agreements, and a number of BASAs with over 100 countries. In 1997, Singapore became one of the first Asian countries to sign such an agreement with the US.¹⁶⁵ It is obvious that the aggressive Singaporean approach in pursuing these agreements is driven by the geography of the country, in which lack of domestic service. Singapore has long been in the frontline of open skies agreements since there are more to gain than to lose from liberalization. With a small domestic hinterland, Singapore relies upon international traffic to feed its hub. Therefore, building a vast international connection is the most plausible way to expand the market and grow its airlines, especially Singapore Airlines.¹⁶⁶

C.2. Sub-Regional

During the First ASEAN Transport Ministers (ATM) Meeting in 1996 in Bali, the Member States agreed to pursue liberalization in air transport at a sub-regional level. The applicable sub-region groups are BIMP-EAGA, CLMV, and IMT-GT.

C.2.1. BIMP-EAGA

BIMP-EAGA¹⁶⁷ was launched in 1994 aiming for accelerating economic development in the selected focus areas of the Member States. The focus areas are some parts of the States that are geographically neighbours: (1) Brunei Darussalam; (2) Kalimantan, Sulawesi, Maluku, West Papua, and Papua in Indonesia; (3) Sabah, Sarawak and the Federal Territory of Labuan in Malaysia; and (4) Mindanao and Palawan in Philippines.

¹⁶³ Thomas R. Leinbach & Richard Ulack, *supra* note 7, at 240.

¹⁶⁴ *Ibid.*

¹⁶⁵ John Bowen, *supra* note 19, at 104.

¹⁶⁶ David Timothy Duval (ed.), *supra* note 3, at 116.

¹⁶⁷ Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area

The Memorandum of Understanding on Air Linkages between the Member States of BIMP-EAGA was first signed and entered into force on 21 February 1995. It was later amended on 12 January 2007 and entered into force on 19 November 2007. It provides for unlimited Third, Fourth and Fifth freedom traffic rights for passengers and cargo services between the designated points.¹⁶⁸ The agreement allows for multiple designation and unrestricted capacity, frequency, and aircraft type. However, there is no specific regulation on tariffs and pricing. In addition, the MoU prohibits cabotage operation and still maintains the traditional substantial ownership and effective control rule.¹⁶⁹

C.2.2. CLMV

The CLMV countries, consisting of the Kingdom of Cambodia, Lao PDR, the Union of Myanmar and the Socialist Republic of Vietnam, were the last four countries to join ASEAN.¹⁷⁰ Before adopting the CLMV Multilateral Agreement on Air Services in 2003, these countries had concluded the Agreement on the Establishment of Sub-regional Air Transport Cooperation of CLMV States in 1998. The CLMV Agreement provides for unlimited capacity and traffic rights, including Fifth freedom rights across the Member countries. It includes multiple designation and dual disapproval tariff mechanism. There is no specific policy with respect to the ownership and control rule, nor the competition between the Member States' airlines. Internally, the CLMV Agreement allows for two States to initiate a cooperative agreement to be followed by other Members when ready. Externally, it allows for non-Member States to join the agreement subject to the approval of all Members.

C.2.3. IMT-GT

IMT-GT (Indonesia, Malaysia, and Thailand Growth Triangle) was established in 1993 aiming for developing some selected economic regions of respective Member States, i.e.: (1) Aceh,

¹⁶⁸ The points designated by the parties: (1) Brunei Darussalam: Bandar Seri Begawan; (2) Indonesia: Balikpapan, Manado, Pontianak and Tarakan; (3) Malaysia: Kota Kinabalu, Kuching, Labuan, Miri; and (4) the Philippines: Davao City, General Santos, Puerto Princessa, Zamboanga.

¹⁶⁹ "...that said airline(s) are substantially owned and/or effectively controlled by the nationals of the Participating Party designating the airline." See Point 6.2 Memorandum of Understanding between the Governments of Brunei Darussalam, Indonesia, Malaysia, and Philippines on Expansion of Air Linkages, online: <bimpeagabc.com/wp-content/uploads/2015/04/1ca9772e-331a-4edf-b4e0-dd1cf2bd8053.pdf> .

¹⁷⁰ CLMV member countries are among the least developed countries and the poorest ones in the world that transformed the ASEAN structure from two-tiered (middle and high income countries) to three-tiered structure (low, middle, and high income countries).

North Sumatera, West Sumatera, Riau, Jambi, Bengkulu, Bangka Belitung and Lampung in Indonesia; (2) Kedah, Perlis, Perak and Penang in Malaysia; and (3) the southern part of Thailand.

Similar to the other ASEAN sub-groupings, IMT-GT also has produced an MoU in air transport cooperation,¹⁷¹ and unveiled an equivalent degree of relaxation as that in the BIMP-EAGA Multilateral Agreement. The MoU allows for unlimited traffic rights to the Fifth freedom for the secondary and tertiary designated points, including: (1) Medan, Padang, Banda Aceh, and Nias in Indonesia; (2) Langkawi, Alor Setar, Ipoh, and Kota Bharu in Malaysia; and (3) Hat Yai, Narathiwat, Pattani, Trang and Nakon Si Thammarat in Thailand.

Overall, the sub-regional groupings have pursued liberalization on Third, Fourth, and Fifth freedom traffic rights on the points covered under each regional grouping. Indeed, liberalization in the sub-set level has underpinned the open sky initiative within Southeast Asia region. Yet, these agreements have only dealt with the peripheral markets, and are applied on a case-by-case basis subject to the bilateral agreements concluded by the respective parties. Moreover, the MoUs under this sub-regional scope provide liberalization in a limited fashion, in terms of pre-defined capacity, operational points, and frequency of operation by the specified airlines. Matters related to ownership, designated airlines and other ‘traffic rights’ elements are still supplemented by the existing bilateral/multilateral air services agreements between the Member States.¹⁷²

C.3. Regional

Over the years, the ASEAN States have shifted their focus on to further cooperation to open up and integrate the ASEAN aviation market at the regional level. The cooperation and integration of the ASEAN transport sector has been guided by a series of ministerial meetings, draft frameworks, and consecutive plans of action.

As early as 1992, the Framework Agreement on Enhancing ASEAN Economic Cooperation had set a motion for an integrated transport network. This was driven by the belief that an efficient, secure, and integrated transport network in ASEAN is vital for: (1) realizing the full potential of

¹⁷¹ Memorandum of Understanding between the Governments of Indonesia, Malaysia, and Thailand on Expansion of Air Linkages was firstly signed and enforced in 1995, then amended on 4 September 1996, 12 January 2001, and 11 August 2006. Online: <treaty.kemlu.go.id/uploads-pub/5486_TRI-1995-0010.pdf> .

¹⁷² Sarah Fox & Rosida Ismail, “ASEAN Open Skies- Aviation Development in 2015: Blue or Cloudy Skies?” (2015) 40 Ann Air& Space L 607 at 627.

the regional economic integration, (2) further enhancing the attractiveness of the region as a single production, tourism and investment destination, and (3) narrowing development gaps in the region.

At the regional level, liberalization has been undertaken in two different policy areas: ancillary services and air traffic rights. Air transport ancillary services may be referred to as “soft rights” that are categorized as business activities, as opposed to the services directly related to the exercise of traffic rights. Computer reservation systems, aircraft repair and maintenance, and the selling and marketing of air transport services are some of the components under this category. Meanwhile, liberalization of air traffic rights may be referred to as “hard rights” that cover matters related to direct air transport operations, such as routes, capacity, designations, and other economic aspects.¹⁷³

The former category falls under the ASEAN Framework Agreement on Services (AFAS). This framework has a close connection to the General Agreement on Trade in Services (GATS) approaches.¹⁷⁴ It is noteworthy that air transport services are also governed internationally under the WTO jurisdiction through a specific annex of the GATS. However, the annex excludes the traffic rights and services directly related to traffic to be regulated under the agreement.¹⁷⁵ As of 2015, there were six rounds of negotiations, and Eight Packages of Commitments were completed under the AFAS, yet only Malaysia has ratified the Eighth Protocol since.

Fox and Rosida concluded that most of the instruments have taken more than a year to fully enter into force after signing. Even though the ASEAN Member have a divergent commitment to open up various sub-sectors of the air transport industry, several commitments by the Members extend beyond their GATS commitments.¹⁷⁶ It means that the AFAS offers further liberalization

¹⁷³ Ibid, at 634.

¹⁷⁴ AFAS resembles the liberalization concept as in GATS through four Modes of Supply: (i) Mode 1 (Cross-Border Supply: the service moves across the border; (ii) Mode 2 (Consumption Abroad: the customer moves across the border to receive the service); (iii) Mode 3 (Commercial Presence: the producer moves across the border to provide the service through commercial establishment); and (iv) Mode 4 (Movement of Natural Persons: the producer moves across the border only temporarily to provide the service.

¹⁷⁵ “The Agreement, including its dispute settlement procedures, shall not apply to measures affecting:

- (a) traffic rights, however granted; or
- (b) Services directly related to the exercise of traffic rights, except as provided in paragraph 3 of this Annex.”

“3. The Agreement shall apply to measures affecting:

- (a) aircraft repair and maintenance services;
- (b) The selling and marketing of air transport services;
- (c) Computer reservation system (CRS) services”

See Annex on Air Transport Service, online: <www.wto.org/english/docs_e/legal_e/26-gats_02_e.htm#annats5>.

¹⁷⁶ Sarah Fox & Rosida Ismail, *supra* note 172, at 620-623.

to its Members rather than the GATS, especially in terms of the coverage of the sub-sector, confirming their willingness to offer additional sub-sectors for liberalization.¹⁷⁷

D. ASEAN Open Skies Agreements

D.1. Negotiation Process

The seed for air transport liberalization in ASEAN was initially planted in the 27th ASEAN Economic Ministers Meeting (AEM) in 1995 that endorsed the possibility to develop an open-sky policy for ASEAN in the amendment of the Plan of Action in Transport and Communication.¹⁷⁸ The meeting between the ATM was consistently conducted to achieve such an initiative.¹⁷⁹ As noted previously, this initial push towards liberalization only dealt with soft rights, such as marketing and reservation systems. Hard rights, such as traffic and capacity rules, were still off the negotiation table.¹⁸⁰

The course of greater integration was not slowed down by the financial crisis in 1997/1998. Instead, ASEAN was committed to deepen the integration by adopting the Successor Plan of Action in Transport 1999–2004 to execute the 1998 Hanoi Plan of Action’s Transport Priorities.¹⁸¹

¹⁷⁷ Ibid, at 625.

¹⁷⁸ The ASEAN Plan of Action in Transport and Communication 1994-1996 was formulated by the working group under Senior Economic Official Meeting in early 1995. The ASEAN Transport Ministers (ATM) followed up this amendment in their First formal session in March 1996. They concluded a Ministerial Understanding establishing a formal mechanism for cooperation and coordination and institutionalized the ASEAN Senior Transport Officials Meeting (STOM). It also revised the implementation time frame of the Plan of Action from 1994-1996 to 1996-1998. Working Groups were formed to establish the work program for theme issues under the Plan of Action 1996-1998, which, in order of priority, were:

- (1) Development of Multimodal Transport and Trade Facilitation.
- (2) Development of ASEAN Interconnectivity in Telecommunications, including Fixed and Mobile Voice and Data and EDI Services for Trade and Business Communication, and to Enhance Land, Sea and Air Transport.
- (3) Harmonization of Road Transport Laws, Rules and Regulations in ASEAN.
- (4) Improvement of Air Space Management in ASEAN.
- (5) Safety of Maritime Transport and Prevention of Pollution from Ships.
- (6) Human Resources Development in Transport and Communications.
- (7) Development of a Competitive Air Services Policy, which may be a gradual step towards an Open-Skies Policy in ASEAN.

¹⁷⁹ In February 1997, the Second ASEAN Transport Ministers Meeting was held, which discussed about the development of competitive air services policy and the initiative of air services liberalization work program. In September 1997, the Third ATM agreed to accelerate the work program. The development of a competitive air services policy was included as one item of the integrated implementation program for the ASEAN Plan of Action in Transport and Communications in 1997, targeted at the ASEAN sub-regional groupings and growth areas. An internal ASEAN Secretariat study on ‘Preparing ASEAN for Open Sky’ was subsequently commissioned.

¹⁸⁰ Dexter Lee, “The European and Southeast Asian Single Aviation Markets” Background Brief No. 15 (2015) online: <www.eucentre.sg/wp-content/uploads/2015/07/BB15-EU-and-ASEAN-aviation.pdf>.

¹⁸¹ The transport action agenda adopted in the Hanoi Plan of Action in 1998 called for:

The action plan enhanced some regulatory and competition policy options for the ASEAN civil aviation sector as one of its strategic thrusts. Specifically, it called for the development of the liberalization policy for air freight services and the adoption of more liberal and flexible air services arrangements, especially in the ASEAN sub-regional groupings.¹⁸²

In 2001, the 7th ATM Meeting 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 MOU on Air Freight Services signed in September 2002 is a first step towards the full liberalization of air freight services in ASEAN. Contracting parties are allowed to operate only all-cargo services up to 100 tons weekly based on a point-to-point route, with no limitations on frequency and aircraft type. Third and Fourth Freedom Rights are included in this agreement. In 2007, the agreement was amended to increase the permitted capacity to 250 tons weekly.

In November 2004, the 10th ATM was held in Phnom Penh with the adoption of a document called the Action Plan for ASEAN Air Transport Integration and Liberalization 2005-2015. The Action Plan targeted the date of 2015 to achieve an effective “open skies” regime for the region. The Action Plan was complemented by The Roadmap for Integration of Air Travel Sector (RIATS) that covers the liberalization of both cargo and passenger air services. The RIATS aimed to fully liberalize air cargo services by 2008 and allow Third, Fourth, and Fifth freedom flights to the regional air passenger service providers between designated points within ASEAN sub-regions by 2006, and between ASEAN capital cities by 2010.

Meanwhile, the RIATS commitments for passenger services confer:

- Unlimited 3rd and 4th freedom flights for all designated points within ASEAN sub-regions by 2005, and for at least two designated points in each country between the ASEAN sub regions by 2006;

1. Progressive liberalization of trade in services, notably through adoption of alternative approaches to liberalization;
2. Development of the trans-ASEAN transportation network, including civil aviation, major road and rail corridors, principal ports and sea lanes, and inland waterways;
3. Implementation of the ASEAN framework agreement and multimodal transport; and
4. Adoption of harmonized vehicle standards and regulations.

¹⁸²BIMP-EAGA and CLMV.

- Unlimited 5th freedom traffic between designated points within the ASEAN sub-regions by 2006, and at least two designated points in each country between the ASEAN sub-regions by 2008;
- Unlimited 3rd and 4th freedom flights between the capital cities by 2008;
- Unlimited 5th freedom flights or the capital cities by 2010.

Subsequently, these commitments were formalized as two legal agreements, namely the Multilateral Agreements on Air Services (MAAS) and the Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS), adopted in 2009 and 2010 respectively. Meanwhile, the agreement for cargo transport, the Multilateral Agreement for Full Liberalization of Air Freight Service (MAFLAFS), entered into force in 2009.

In 2010, the ASEAN Transport Ministers endorsed the ASEAN Strategic Transport Plan (ASTP) 2011-2015, also referred to as the Brunei Action Plan (BAP) 2011-2015 as a reference and guidance for ASEAN transport cooperation and integration. Within this document, the notion of the ASEAN SAM is emphasized. In addition, the Member States are strongly encouraged to ratify and implement the RIATS and the MAFLPAS, as well as liberalization of air transport ancillary services by 2015.¹⁸³

Furthermore, ASEAN has appended an open skies agreement with China and is in the process of entering into similar arrangements with bigger economies, such as India,¹⁸⁴ Japan,¹⁸⁵ South Korea¹⁸⁶ and the EU. Besides the formulation of BAP, the ATM meeting in Brunei also resulted in a sideline air transport agreement between ASEAN, as a block, and the People's Republic of China. This plurilateral agreement may replace the existing bilateral air services agreements between the ASEAN Members (individually) and China.¹⁸⁷

¹⁸³ Brunei Action Plan (BAP) 2011-2015 constitutes three main goals for air transport sector:

1) Establish an ASEAN Single Aviation Market; 2) Promote environmentally friendly aviation; and 3) Enhance engagement with Dialogue Partners to promote greater connectivity.

¹⁸⁴ Joint Ministerial Statement of the 17th ASEAN Transport Ministers (ATM) Meeting (Phnom Penh, Cambodia, 16 December 2011).

¹⁸⁵ Joint Ministerial Statement of the 8th ASEAN and Japan Transport Ministers Meeting (Bandar Seri Begawan, 12 November 2010).

¹⁸⁶ Joint Ministerial Statement of the 16th ASEAN Transport Ministers' Meeting (Bandar Seri Begawan 11 November 2010).

¹⁸⁷ Alan Tan, "The 2010 ASEAN-China Air Transport Agreement: Placing the Cart before the Horse?" (2012) 37 J Air & Space Law 35.

D.2. The Regulatory Framework

At a glance, the open skies policy in ASEAN is intended to increase regional and domestic connectivity, integrate production networks and enhance regional trade by allowing ASEAN airlines to fly freely throughout the region under a single air transport market. The policy removes restrictions on Third, Fourth, and Fifth freedoms for airlines registered in the jurisdiction of all ASEAN Members. This way, the ASEAN-based airlines are free to transport people and cargo to or from a foreign country and to pick up and drop off people and cargo from a second country *en route* to a third country. Under this policy, each Member is expected to expose their international airports to other Members and eliminate restrictions on the frequency and maximum capacity of flights.

As above-mentioned, the open skies regime in ASEAN manifests in air cargo and passenger service liberalization under the auspice of three agreements: the Multilateral Agreement on Full Liberalization of Air Freight Services (MAFLAFS), the Multilateral namely Multilateral Agreements on Air Services (MAAS), and the Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS). Attached to each agreement is a set of implementing protocols that detail the actual market access relaxation scheme. Each of the protocols needs to be ratified on its own terms like a separate convention.

Of the myriad aspects constituting an open-skies model agreement, substantial relaxation of market access and nationality rules are the most crucial factors for the success of a single market proposal. The two are assessed as follows:

D.2.1. Market access

Market access defines traffic rights and specific landing points. Generally, air service agreements (ASAs) grant Third and Fourth freedom rights, but only some provide for the Fifth freedom and beyond. Therefore, the restrictiveness of an ASA may be measured by the granting of Fifth freedom, cabotage rights, and the number of landing points. The most restrictive ASAs may be characterized by the provisions in which neither Fifth freedom nor cabotage rights are granted, and/or limited access to only a single origin/destination point at each end of the route. Less restrictive ASAs provide for limited Fifth freedom rights or/and multiple landing points in

one or both respective countries. The most liberal ASAs give airlines open access to all airports in both countries, including the right of unrestricted cabotage to the airlines.¹⁸⁸

a) Air Freight

The agreement on cargo liberalization was the first instrument achieved by the ASEAN Members in the course of open sky agenda and garnered ratification at a rapid pace. The commitments to full liberalization in air freight services is formalized in 2009 by the adoption of Multilateral Agreement on Full Liberalization of Air Freight Services (MAFLAFS) and two implementing protocols.

Protocol 1 provides for unlimited Third, Fourth and Fifth freedom all-cargo traffic rights between designated points in ASEAN. Protocol 2 frees up similar rights for all points in ASEAN with international airports.

This relaxation is consistent with the less controversial nature of air cargo transport, and contemplates the reality of air freight services. Cargo flights typically operate from Points A to B, and onwards to C, D, E and so on, without strict requirements on returning to the carrier's home states (unlike passenger flights). At all points along the route, there are typically minimal or no restrictions on the right to discharge and pick up cargo.

b) Passenger

Two agreements and several implementing protocols have been adopted in the field of passenger air service: Multilateral Agreements on Air Services (MAAS)¹⁸⁹ and the Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS).¹⁹⁰

MAAS consists of 19 articles and two Annexes.¹⁹¹ The six implementing protocols attached in MAAS are:

- Protocol 1: Unlimited Third and Fourth Freedom Traffic Rights Within ASEAN Sub-Region;
- Protocol 2: Unlimited Fifth Freedom Traffic Rights Within ASEAN Sub-Region;

¹⁸⁸ David W. Gillen, et.al. *supra* note 48, at 32.

¹⁸⁹ MAAS was adopted by the Transport Ministers of ASEAN Member States at the 14th ASEAN Transport Ministers Meeting in Manila, Philippines on 20 May 2009.

¹⁹⁰ MAFLPAS was signed by Transport Ministers on 12 November 2010 in Bandar Seri Begawan, Brunei Darussalam.

¹⁹¹ MAAS Annex I stipulates routing and operational flexibility rules. MAAS Annex II enlists six implementing protocols as the integral parts of the agreement.

- Protocol 3: Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Sub-Regions;
- Protocol 4: Unlimited Fifth Freedom Traffic Rights Between ASEAN Sub-Regions;
- Protocol 5: Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Capital Cities; and
- Protocol 6: Unlimited Fifth Freedom Traffic Rights Between ASEAN Capital Cities.

MAFLPAS basically provides complementary rights to those already stipulated in MAAS. The latter governs the capital city relaxations and relaxations between and within specified sub-regions within ASEAN. Whereas, MAFLPAS governs the operation among all other points in ASEAN, including the secondary cities.

Additional relaxation is provided under MAFLPAS's implementing protocols:

- Protocol 1 Unlimited Third and Fourth Freedom Traffic Rights Between Any ASEAN Cities; and
- Protocol 2 Unlimited Fifth Freedom Traffic Rights Between Any ASEAN Cities.

Both agreements have entered into force and are greatly significant to advancing the ASEAN SAM commitments. However, the single aviation market envisaged by the two agreements seems incomplete. Although unlimited Third and Fourth freedoms are provided, none of the Agreements accords for beyond Fifth freedom traffic rights, including cabotage rights. The Agreements still outlaw the ASEAN-based carriers from carrying domestic passengers of other ASEAN countries, or picking up passengers in an overseas destination and carrying them to a third destination in the region. Simply put, any international operation still has to begin or end in the carriers' home state. For example, Lion Air cannot fly between Singapore and Kuala Lumpur unless the flight departs from or is *en route* to Jakarta.

D.2.2. Ownership and control rules

MAAS and MAFLPAS introduce two revolutionary concepts beyond the traditional substantial ownership and effective control arrangements. The first concept governs the substantial ownership and effective control to reside in one or more ASEAN Members or to originate from

the ownership combination of ASEAN nationals.¹⁹² It thus allows for the community carrier operation that reposes majority ownership region-wide, given that the principal place of business and incorporation is in one of the Members. For example, a carrier registered in and designated by Cambodia could have 20% of its shares owned by the Malaysian interests, 20% by the Thai interests, 11% by the local Cambodian interests, with the remaining shares owned by the investors of any nationality whatsoever. This arrangement is permissible under the Agreements as long as it is incorporated in and has its principal place of business in Cambodia, and the Cambodian government has an effective regulatory control over it.¹⁹³ This takes the process of liberalization a step forward, as it allows for majority ownership and effective economic control of carriers by interests outside the designating state, given that these are from within the ASEAN grouping in the aggregate.¹⁹⁴

The second concept formulates that a carrier does not have to be substantially owned or effectively controlled by the Members, as long as it is incorporated and has its principal place of business in the designating State.¹⁹⁵ The State must possess and maintain effective regulatory control over the airline. Hence, this opens up the intriguing possibility of the airlines in ASEAN being owned and economically controlled by interests from outside the region. This possibility, however, is subject to two major qualifications. One is the requirement that each Contracting Party receiving the airline's application must approve its operations. The other condition relates to the requirement that the arrangement will not be equivalent to allowing airlines or their subsidiaries access to traffic rights not otherwise available to them. Hence, non ASEAN carriers cannot automatically have access for intra-ASEAN routes even though they buy into an ASEAN carrier.¹⁹⁶

For example, an Australian carrier bought 60% share of Myanmar-based carrier which was about to bankrupt based on the law of Myanmar. Since the failing airlines then became the Australian subsidiary, all of the elements of the company, such as the employee uniform, logo, color, and other components would follow its Australian headquarters. In its operation, this revitalized carrier, however, could not be designated to fly over Indonesia even though it had been

¹⁹² Art 3 (2) (a) (ii)

¹⁹³ Alan Tan, "The ASEAN Multilateral Agreement on Air Services: *En Route* To Open Skies?" (2010) 16 J Air Transp Mgmt 289, at 291.

¹⁹⁴ Ibid, at 292.

¹⁹⁵ Art 3 (2) (a) (iii).

¹⁹⁶ Alan Tan, *supra* note 193, at 292.

designated by the Myanmar government if the Indonesian government refused that designation. Otherwise, it could operate by Third and Fourth freedom rights but not the Fifth, depending on the permit given by the corresponding parties.

Nevertheless, the criticism remains on the implementation of such nationality rules. In this matter, a carrier established according to a trans-ASEAN ownership and control model must obtain specific approval from each country within ASEAN to or from which it wants to operate. As such, whether this typical carrier can operate to all countries in the region remains uncertain, given that any country could legitimately reject their designation to flying to its territory.¹⁹⁷ A further analysis on this issue will be provided in the following sub-chapter on the discussion of ASEAN Community Carrier.

E. Implementing the ASEAN Open Skies Agreements: The Prospect and Corresponding Challenges

The policy incorporated in the AOSAs is intended to boost connectivity and increase the traffic growth by granting all designated ASEAN-airlines access to all international airports in Southeast Asia. The agreements consist of a number of distinct policy aspects that should lead to less regulation in airline services.¹⁹⁸

E.1. Enforcement Procedure

MAAS, MAFLAFS, and MAFLPAS are in force by the acceptance of minimum three ASEAN States for each. The Agreements are envisaged to be fully implemented in the beginning of 2016 across ASEAN countries. However, until the deadline had passed, some Members, such as Indonesia, the Philippines, and Laos, remained on the sidelines.¹⁹⁹ Protecting its substantial domestic market is purportedly of paramount concern for Indonesia as it anticipates the *carte blanche* entry of bigger carriers like Singapore Airlines or Thai Airways may put its domestic carriers at risk.²⁰⁰ Meanwhile, the Philippines still excludes Manila Ninoy Aquino International

¹⁹⁷ Alan Tan, *supra* note 193, at 292.

¹⁹⁸ Sri Nurhendiarni, et. al., *supra* note 154, at 35.

¹⁹⁹ Indonesia and Laos ratified the 2010 MAFLPAS including the implementing protocols on 7 April 2016, while the Philippines ratified the Fifth and Sixth MAAS protocols on 11 March 2016.

²⁰⁰ Ruwantissa Abeyratne, “ASEAN Single Aviation Market and Indonesia - Can It Keep Up with the Giants?” (2014) 2 Indonesia L Rev 163 at 166.

Airport from other ASEAN carriers due to rigorous congestion. Eventually, the AOSAs achieved full ratification in May, with Indonesia and Laos being the last Contracting Parties.²⁰¹

While aviation integration policies have automatic force of law in Europe, they must be voluntarily agreed upon by each Member State in ASEAN. The single market procedure in ASEAN adheres to a mechanism referred to as the “ASEAN *Minus X* formula”.²⁰² This mechanism enables all ASEAN Members to opt out of the agreement if they deem themselves not ready to implement it. This formula was originally proposed by Singapore and Thailand (both known as the home of aggressive and competitive airlines) at the Ninth ASEAN Summit in Bali in October 2003, and fully supported by Brunei Darussalam (known for its small domestic market).²⁰³ They always become the initiator for early ASEAN Agreements that liberalize air cargo²⁰⁴ and passenger services.²⁰⁵ Such a method accommodates more flexibility by allowing a sub-group of States to liberalize ahead of others, although the end result would unlikely be a unified regional effort to pursue common market.

At a glance, the open skies policy in ASEAN has allowed flight frequencies to increase and attract more inward and outward travel. Prior to this, the flight frequencies between the ASEAN countries were restricted and the ticket prices were higher. As tourism and trade are seen to benefit from liberal access, government policies are steadily relaxed and prepared for a much more receptive environment for the progressive and more formal deregulation of the ASEAN multilateral agreement. Thus, the governments of the leading tourist destinations in Asia, such as Singapore and Thailand, have pursued liberal policies in terms of their international air service agreements. The Singaporean government, for example, has been particularly liberalizing the regulations in air transport services responsible for developing tourism market.²⁰⁶

Nevertheless, it seems too early to claim that liberalization of air transport provisions in ASEAN have increased the economic returns from tourism sector. Moreover, the lack of

²⁰¹ Further details of the date of ratification on each instrument are attached in the Appendix 1.

²⁰² Implementation Framework of the ASEAN Single Aviation Market, Implementation Mechanism no. 11.

²⁰³ The trios have been the primary drivers of the so-called ASEAN 2+X formula. The formula is designed for smaller groups of like-minded countries to liberalize earlier between themselves and for others to follow suit when they are ready to do so. Alan Tan, “Prospects for A Single Aviation Market in Southeast Asia” (2009) 34 Ann Air & Space L 253 at 258.

²⁰⁴ *Multilateral Agreement on the Full Liberalization of All Cargo Air Services*, adopted 25 February 2004. The parties of this agreement are Singapore, Thailand, Brunei Darussalam, and Cambodia.

²⁰⁵ *Multilateral Agreement for the Liberalization of Air Passenger Services*, adopted 27 December 2004. There are no other parties of this agreement beside Singapore, Thailand, Brunei Darussalam.

²⁰⁶ Brian Graham, *supra* note 8, at 206.

infrastructure is still looming. Most of the ASEAN main hubs have already been slot-congested and capacity-constrained. Soekarno-Hatta and Ninoy Aquino had run out of slots even before the agreements were ratified by the respective governments. What is the point of open skies if there are no landing slots available for new entrants? From the consumer's, this condition may affect the travel experience as the lack of ground infrastructure will result in flight delays and overcrowded terminals.²⁰⁷

E.2. Proliferation of Cross-Border Joint Ventures

Budget carriers or well-known as Low Cost Carriers (LCCs) have been the preferred mode of air travel for the ASEAN population. They have even become the main driver for the development of the aviation industry in Southeast Asia.

Notably, the ASEAN budget airlines have entered a new phase since the deregulation of air transport policies enforced through the ASEAN Open Skies policies. As the regulations are more relaxed, the LCC's penetration is more robust and has become a serious competitor for the FSC-type (Full Service Carrier). A study by Shinya Hanaoka et.al. concludes that LCCs' entry considerably decreases the FSCs' profit, and FSCs may consequently lose transit passengers in their hub airports. The no-frills carriers benefit from intra-ASEAN routes that mainly confer short distances. In other words, the travel pattern in this region provides more favorable market circumstances for LCCs rather than FSCs.²⁰⁸

Today, LCCs account for two-third of the regional airlines seats. Despite the fact that growth slowed down in 2014 and 2015, and is predicted to be flat in the coming years, the penetration rate for Southeast Asia is higher than any other region or sub-region, including Western Europe and North America.²⁰⁹ ASEAN LCCs also have expanded their fleet to long haul travel using wide-body aircrafts, connecting Southeast Asia with other regions, particularly in Asia Pacific.²¹⁰ This

²⁰⁷ "ASEAN airports face congestion, warns global body" (2015) online: <www.straitstimes.com/singapore/transport/asian-airports-face-congestion-warns-global-body> .

²⁰⁸ Shinya Hanaoka, et.al, "Low-Cost Carriers Versus Full Service Carriers in ASEAN: The Impact of Liberalization Policy on Competition" (2014) 40 J Air Transp Mgmt 96 at 104.

²⁰⁹ Airline Leader, "Southeast Asia Outlook: Lower growth and improved profitability for the second consecutive year" (Issue 32, 2016) online: <www.airlineleader.com/categories/regions/southeast-asia-outlook-lower-growth-and-improved-profitability-for-the-second-consecutive-year-263091> .

²¹⁰ Among the ASEAN LCCs operating the wide-body aircraft are Scoot (Singaporean LCC), AirAsia X (Malaysian LCC with cross-border joint venture), Cebu Pacific Air (Filipino's LCC), and Lion Air (Indonesian LCC with cross-border joint venture). See Jennifer Meszaros, *supra* note 131.

hybrid model is enabled by the open skies policy stipulated in the MAAS and MAFLPAS that allows carriers to upgrade their ASEAN flights to wide-bodied aircrafts, and increase capacity without the need for further negotiation.

Notwithstanding the flexibility accorded to the fast-expanding LCCs, the AOSAs are limited to the use of Fifth freedom rights (and, to a certain extent, Sixth freedom as a result of unlimited Third and Fourth freedom) with a restriction on flights only to designated cities. Moreover, foreign investors (non-ASEAN nationalities) are still forbidden to hold an outright majority of shares. As a result, most of the ASEAN's LCC operation will remain point-to-point.

In the meantime, joint venture (JV) arrangements offer an alternative to this predicament. These JV equations are widely recognized and accepted in Asia and the world.²¹¹

Jae Won Lee broadly classified the JV practices into two models: incorporated JVs and unincorporated JVs. The former consists of an airline set-up as an independent unit (like many Asian LCC, such as AirAsia, Lion Air, Jetstar, Spring Airlines, Tigerair and Vietjet),²¹² while the latter consists of an airline operation based on contractual clauses agreed upon by their parent companies to carry out specific or limited purposes (such as American Airlines-Japan Airlines JV and United Airlines-All Nippon Airways JV).²¹³

In practice, a JV airline is a local carrier for bilateral (or in this thesis is multilateral) purposes. Fifty percent *plus* of the shares are owned by the local interests to declare the company as “substantially owned” by nationals of the designating state, despite the local partners are purportedly passive. Foreign carriers may collaborate with local non airline companies or local companies that have poor or no business experience in the airline industry, or with local airlines and their subsidiaries.²¹⁴

²¹¹CAPA, “LCC models in Southeast Asia evolve as growth slows, though outlook remains bright” (2016) online: <centreforaviation.com/analysis/lcc-models-in-southeast-asia-evolve-as-growth-slows-though-outlook-remains-bright-281589>.

²¹² An incorporated joint venture is a “full function” joint venture that “is established by the parties with the intent that it should have its own employees, assets, facilities, funding and markets and generally carry on business as an autonomous economic entity.” Jae Won Lee, *supra* note 43, at 184.

²¹³ An unincorporated joint venture is a “limited-function” joint venture that “is not an autonomous or independent unit but one which [is] designed to carry out a more specific and limited role under the direct control of its parents. *Ibid.*

²¹⁴ Collaborating with the non-airline companies might offer more *de facto* control to foreign investors, however this alternative would not work as desirable if the local government has a strict supervision of the effective control rule. Hence, the foreign investor is likely to choose the second alternative. *Ibid.*, at 185-189.

In Asia, the governments have more tendency to allow the foreign control to dominate in the JV arrangement for the lax supervision on the “effective control” requirement in most of their air transport agreements.²¹⁵ One of the examples is the Malaysian-owned AirAsia Group, consisting of Thai AirAsia, Indonesia AirAsia, and the Philippines AirAsia.

According to Alan Tan:

“[These] [sic] ‘subsidiaries’ are held out to be technically distinct from the parent AirAsia, with their own IATA flight designator codes, boards of directors (with a majority of local members), and also local CEOs. Majority ownership remains with local concerns that are, notably, non-airlines interests with minimal or no experience in the airline business. At the same time, the carriers utilize the international route rights of their respective States. Hence, Thai AirAsia and Indonesia AirAsia utilize Thailand’s and Indonesia’s rights under these countries’ respective bilateral air service agreements with other countries. Despite the technical differences, the fleets of all three ‘sister’ carriers are painted with the same red-and-white AirAsia livery and marketed by a common branding strategy. Bookings on the website are done through a common internet platform, and there is little doubt that management expertise is provided by the (Malaysian) minority owner. For commercial purpose, AirAsia appears to operate as a single indistinguishable carrier out of three hubs - Kuala Lumpur, Bangkok, and Jakarta.”²¹⁶

In fact, the JV model has allowed the ASEAN carriers to confront the regulatory barriers. The issue of effective control seems less critical as long as foreign investors own no more than 49% of shares in these airline companies and no bilateral partners object to the lack of effective control on the part of the designating State. This operational model has allowed the parent carrier to establish multiple hubs and operations across Asia, and simultaneously bypassing ownership/control and Seventh freedom hubbing restrictions. In short, the industry has found that regulators do not appear unduly concerned about the effective control element as long as majority ownership can be shown definitively to reside in local hands.²¹⁷

The fact that such a cross border JV is tolerated by some ASEAN governments attests to its functional utility in circumventing the restrictive open skies regime. Hence, whatever the strictures will be, there already exists a *de facto* relaxation of ownership and control restrictions. However,

²¹⁵Ibid.

²¹⁶ Alan Tan, *supra* note 203, at 263-264 by the time this writing published, Philippines AirAsia was not established yet.

²¹⁷ Ibid, at 264.

the concern here is that this approach is not reflected in specific policy and remains arbitrary and subject to *ad hoc* conditions.²¹⁸

E.3. ASEAN Community Carrier

As is above mentioned, the open skies policy in ASEAN has laid out the concept of community carrier. Article 3(a) paragraph (ii) and (iii) explicitly confer the establishment of community carriers. The carrier's nationality has to reside in ASEAN or, otherwise, must be under regulatory control of the Members. As a matter of fact, no such an airline has been established at the moment. The reason is that the same article contains the conditional clause "*subject to acceptance by a Contracting Party receiving such application*". The paragraph (iii) also puts forward a safeguard clause that prevents the third party free-riding, by which the designation of such a trans-airline is not equivalent to the authorization of certain traffic rights to the airline or its subsidiary.

Accordingly, the AOSAs do not set out a comprehensive regime to embody such a community carrier. The idea of a nationality pool exists here only in the context of a clause concerning the acceptance of airline designations, subject to the discretion of the accepting party. As a result, this regime creates very little legal progress. It also does not ensure any business certainty regarding the exercise of market access rights by community-owned and controlled carriers. In this case, no investors would likely take the risk to establish such a carrier.²¹⁹

Considering that most of the ASEAN Members are still sensitive for the nationality rule, especially if the designating State does not own the majority share or non-ASEAN nationals have a significant investment in the carrier, this model of community carrier is hardly envisioned to operate throughout the region in the near future.

Be that as it may, should the ASEAN community carrier exist, its operation would be much limited than it is supposed to be. The AOSAs' restriction on Seventh freedom and the cabotage application would dilute the function and meaning of "community carrier" itself for its limited operation.

²¹⁸ Ibid.

²¹⁹ Ibid.

F. Analysis and Synthesis

The current open skies policies adopted in the AOSAs fall short in establishing a single aviation market. The Agreements only focus on liberalizing international links between the Members but still alienating the cabotage rights.

With respect to the ideal environment for a single aviation market, four policy areas need to be addressed, including harmonization, competition, liberalization, and external relations policy.

F.1. Harmonization

Harmonization is the process of removing the barriers to trade that had previously been defined by national boundaries. The purpose of harmonizing laws is to sanction against practices, which hinder or threaten the realization of the single market objectives.²²⁰

After examining the provisions contained in the AOSAs, it is apparent that the open skies policy in ASEAN causes a lack of harmonization. The notion of sovereignty remains strongly upheld by the Contracting Parties. The AOSAs leave it to the discretion of each ASEAN State to decide whether a carrier should be designated to operate on certain routes and to regulate the levels of tariffs, at some extents, by applying their own national laws. Moreover, the ASEAN open sky policies concentrate principally on the exchange of traffic rights. The policies do not prescribe common licensing criteria for the ASEAN carriers as in the European Community law, and in turn, do not provide for all licensed carriers to have free access to the market without their governments determining the routes, capacity, frequency and fares the airlines may offer.

In effect, bilateral agreement between the governments still hold a significant role in the open skies regime in ASEAN.²²¹

F.2. Competition

Competition law is of paramount importance to preserving the competition in the market.²²² Competition is crucial to maximize the money value and choice from the point of view of the

²²⁰ Jeffrey Goh, *supra* note 92, at 24

²²¹ Art 7 of MAAS does not require the tariff charged by airlines to be filed with or approved by either Contracting Party. The tariffs will be determined by the parties concerned at their discretion based on the principle of fairness, reciprocity and national interest. See Martono & Ariawan Gunadi. "Current Regulation of Air Transport Tariffs in Indonesia" (2014) 39 *Ann Air & Space L* 163 at 197-198

²²² Jeffrey Goh, *supra* note 92, at 25.

consumer. As noted by MZF Li, the consequence of multilateral open skies regime to the ASEAN carriers might be comparable to the consequence born by the US major carriers in the Deregulation Era, when several major carriers failed or needed radical restructuring. As the agreements give all major ASEAN carriers a hub-ing right at its main international gateways, there is a concern that the flag carriers will be devastated due to intense competition.²²³ Given this underlying assumption, the multilateral agreements require safeguards in respect of competition applied by the Contracting Parties.

In ASEAN, the procedures of enforcing the competition law among member states are varied even though a special guideline on regional competition policy has been signed, known as the Regional Guidelines on Competition Policy. The policy works as a non-binding statement to implement and develop a competition policy in the context of each Member State. They can adopt the policy but remain free as to how they want to formulate the policy into a regulation in their domestic laws. As a result, the Member States have made different decisions as to whether anti-competitive conduct amounts to a civil, administrative or criminal wrongdoing.²²⁴ At the end, the lack of a unified binding tool for competition measures may bring forth an extraterritorial jurisdiction conflict.

F.3. Liberalization

Liberalization is an important underpinning of the single market and the corollary of a market economy; It is the process of removing the institutional barriers to competition.²²⁵ Given that the the abolition of the borders between the subscribing countries is a precondition for the operation of the single market, it is imperative that institutional barriers should be removed to the maximum extent possible.²²⁶

While the agreements specify a gradual extension of Third, Fourth, and Fifth freedoms within ASEAN, it notably allows the Members to retain any sort of withholding clause.²²⁷ By this notion,

²²³ Michael ZF Li, "Air Transport in ASEAN: Recent Developments and Implications" (1998) 4 J Air Transp Mgmt 135 at 140.

²²⁴ Cenuk Sayekti, "ASEAN: Harmonization in competition Law" (2016) online: <www.thejakartapost.com/news/2016/03/08/asean-harmonization-competition-law.html>.

²²⁵ Jeffrey Goh, *supra* note 92, at 26.

²²⁶ *Ibid.*

²²⁷ Withholding defines the ownership conditions required for the designated airline(s) of the foreign country to be allowed to operate the agreed services.

any ASEAN State could pass a national law on foreign investment that allows foreign nationalities to own majority shares of its designated carrier. However, if the other parties require “substantial ownership and effective control” in order to grant the designation, this majority foreign-investment airline may be stopped to offer international air services out of that designing country.²²⁸

In other words, domestic laws have acted as formidable hurdles for liberalization, particularly the laws that impede the establishment of an intra-regional carrier. Some governments remain keen on protecting their flag carriers by issuing domestic aviation laws that potentially prevent the possibility to establish strong regional airlines with a cross-border ownership and/or control (community carrier). Even though the AOSAs have unleashed more progressive alternative clauses against the traditional substantial ownership and effective control rules,²²⁹ the withholding clause has allowed foreign-restricted national investment laws to prevail.

For example, the case of Indonesia AirAsia’s negative equity report may affect the revocation of its operational permit. This airline was established by the joint venture between Malaysia AirAsia Group and some Indonesian locals, with the latter holding the major share. The local partners decline to inject more capitals to the airline due to practical business reasons. Meanwhile, its Malaysian affiliate is also barred from aiding the company due to Indonesian law that restricts a 49% cap on the company’s ownership.²³⁰

That being said, regional liberalization in Southeast Asia is yet to be fully implemented. Yet, it is still a work in progress. To effectively meet the ASEAN Single Aviation Market target, the Members need to liberalize their withholding clauses, at least to allow “community interest.” Community interest expresses an intra-ASEAN airline type, on which the ASEAN States have substantial ownership and effective control as a community or group.

F.4. External Relations Policy

²²⁸ For instance, Singapore allows 70% foreign ownership in domestically established air services companies. However, it could well be prevented from supplying international air services to other ASEAN countries, even if they had ratified the ASEAN Multilateral Agreements on Air Services. This is because that agreement allows them to retain withholding clauses that would require Singapore to have substantial ownership and effective control of Singapore Airlines by Singaporean entities in order to be a designated airline. Philippa Dee, Services Liberalization toward the ASEAN Economic Community, in S. Urata & M. Okabe, “Tracing the Progress Towards the ASEAN Economic Community” ERIA Research Project Report 2009 No. 3 (2010) at 39 .

²²⁹ MAAS, MAFLFS, MAFLPAS Art 3 concerning ownership.

²³⁰ “AirAsia urges govt to relax regulations” (2016) online: <www.thejakartapost.com/news/2016/06/10/airasia-urges-govt-relax-regulations.html>.

A common policy on external relations is essential to maintain the integrity of the single market.²³¹ The reality about ASEAN is that it has never functioned in any way other than a soft association. The norms of the “ASEAN Way”²³² of non-interference and the aversion to a strong central bureaucracy have made ASEAN more of an association than an institution.²³³

The ten Member States of ASEAN lack a supranational framework and a directional facility like the European Commission that can compel States with different interests into accepting a common regional interest.²³⁴ With different stages of development and the strengths of airlines, there is a tremendous variance in aero-political interests amongst its Members.²³⁵ In effect, the ASEAN region is yet to establish itself as a true common aviation market *vis-à-vis* third countries.

The lack of a common policy that advances the regional interest is evident in the ASEAN-China Air Transport Agreement. The agreement was adopted alongside MAFLPAS that aims to replace the existing bilateral air service agreements between the individual ASEAN States and China. This agreement has enabled Chinese carriers to connect any point in China to any point in an ASEAN State that is party to the AOSAs. By contrast, the ASEAN carriers can connect Chinese points to points in their home territories only. This network imbalance occurs due to the Members have failed to liberalize the market access among themselves, constraining for the operation of stand-alone flights from another ASEAN country to and from China.

CHAPTER III

THE RELEVANCE OF ASEAN OPEN SKIES REGIME TO INDONESIA

Within ASEAN, Indonesia represents almost 40 percent of the region’s economic output and is a member of the G20. Its population represents 39% of the total ASEAN population and its land area extends across almost a half of the region’s territory. It has the biggest number of airports with 29 international airports as of 2012, compared to Singapore and Brunei, which only have one international airport and no domestic operation. With respect to the topic of this thesis, the

²³¹ Jeffrey Goh, *supra* note 92, at 28.

²³² The “ASEAN Way” shapes the code of conduct in ASEAN in the means of: 1) non-interference in other States’ affairs; 2) consensus and non-binding plans to treaties and legalistic rules; and 3) building national institutions and actions, rather than creating a strong central bureaucracy. This principle is allegedly the main factor that has prevented ASEAN to move collectively. Hadi Soesastro, *supra* note 150, at 9.

²³³ *Ibid*, at 10.

²³⁴ Alan Tan, *supra* note 187, at 41.

²³⁵ Peter Forsyth, John King & Cherry Ann Rodolfo, “Open Skies in ASEAN” (2006) 12 J Air Transp Mgmt 143, at 144–145.

Indonesian geographical advantage would be crucial for the effectiveness of the open skies policy in ASEAN.²³⁶

A. Overview of Air Transport Industry in Indonesia

A.1. Market Outlook

The Indonesian air transport industry was started by one government-owned carrier: Garuda Indonesia. For more than half of a century, this flag carrier was purely state-owned²³⁷ until its initial public offering in 2011.²³⁸ Since the company's revitalization and restructuring, Garuda has grown rapidly and received several world-renowned awards.²³⁹ However, this ongoing expansion is mainly backed by the Indonesian government's financial support. One notes that the government's decision to back up the national flag carrier should be perceived as a broader strategy aimed at boosting economic growth and fostering higher revenues in related sectors like tourism.²⁴⁰

Since its inception, Garuda Indonesia used to be the price leader and hold monopoly power of the major domestic trunk routes. After the deregulation in Indonesia, Garuda remains the leader at the full-service end of the market for premium passengers class. The airline operates scheduled flights to a large number of destinations, from its main hubs in Jakarta, Surabaya, Medan, Denpasar, Balikpapan, and Makassar to points in Southeast Asia, East Asia, Middle-east, Australia and Europe. Garuda Indonesia connects 76 destinations worldwide with close to 600 daily flights and

²³⁶ Batari Saraswati & Shinya Hanaoka, "Aviation Policy in Indonesia and Its Relation to ASEAN Single Aviation Market" (2013) 10 J Eastern Asian Society for Transp Studies 2161, at 2161-2162.

²³⁷ Garuda's first commercial flight was made on 26 January 1949 from Calcutta to Rangoon using DC-3 Dakota Aircraft with the tail number "RI 001" and the name "Indonesia Airways". The "Garuda" initial was declared by the first Indonesian President, Ir. Soekarno, and initially used to pick up the President from Jakarta to Yogyakarta in the same year. Since then, "Indonesia Airways" commenced its commercial operation under the name "Garuda Indonesia Airways." In 1950, Garuda officially became the state-owned company.

²³⁸ In its first IPO, 28% of its share was sold to the public. Now, Garuda became a state-listed company with the government owns the majority of its share, amounting 60.50% and Credit Suisse AG Trans Airways, amounting 25.90%.

²³⁹ The progress of Garuda's transformation program is evident from the achievement of a Skytrax 5-star airline rating, ranked as the 7th best airline in the world in the 2014, as well as the prestigious "The World's Best Cabin Crew" award in 2014 and "The World's Best Economy Class" award in 2013. Garuda Indonesia has also been named the best airline of the Asia and Australia region by the Airline Passenger Experience Association (APEX) for two consecutive years.

²⁴⁰ Bernardo Bruzzone, "Long-haul perspective for Indonesian aviation" (2016) online: < ms.thejakartapost.com/aviation-outlook-2016/2016/06/15/long-haul-perspective-for-indonesian-aviation/>.

a fleet of 169 aircrafts. International Air Transport Association (IATA) certified Garuda Indonesia as a registered operator under the IATA Operational Safety Audit (IOSA)²⁴¹ in 2008.

In 2012, domestic and international routes were dominated by the five largest airlines: Lion Air, Garuda, Indonesia Air Asia, Sriwijaya, and Batavia, which accounted for a total of 90% of the market share.²⁴² A year later, Batavia ceased its operation due to bankruptcy, but the competition in the Indonesian domestic market intensified, mainly between Garuda and Lion, whose fleets have been expanding rapidly and may potentially squeeze out smaller players. To date, Garuda has expanded its domestic fleet to the low-cost end by launching Citilink, while Lion Air has developed full service subsidiary, Batik Air. As a result, Garuda's market share as a group has increased more rapidly as it has accelerated Citilink's expansion. Citilink passenger traffic was up 24% in 2015 to 9.4 million and has increased nearly six fold since 2011. Lion Group, on the other hand, appears as the market leader in the domestic market with its two no-frills subsidiaries, Wings Air and Lion Air, and one premium class carrier, Batik Air.²⁴³

In the middle of escalated competition in the domestic market, Indonesia AirAsia, by contrast, has decided to halt its fleet expansion.²⁴⁴ As of 2014, Indonesia AirAsia maintains 30 aircrafts and shrank to 26 aircrafts in the early 2016.²⁴⁵ Despite its small share of domestic capacity, this cross-border company between Indonesia and Malaysian-based AirAsia Group is remarkably the largest operator in Indonesia's international market. Benefiting from vast international capacity and reputation acceded by the airline's shareholder, its seat capacity has surpassed Garuda Indonesia for international travel.²⁴⁶ That said, Indonesia AirAsia is likely to gain more from the future single market in ASEAN.

A notable international expansion is made by Lion Group. Following AirAsia as a role model, Lion has built a joint venture with other ASEAN partners to expand its international operation, like Thai Lion Air, based in Thailand, and Malindo Air, based in Malaysia. . Lion is now

²⁴¹ IOSA is an internationally recognized and accepted evaluation system designed to assess the operational management and control systems of an airline.

²⁴² Other major scheduled airlines in 2012 (Merpati Nusantara, Wings Air, Citilink, and Tiger Mandala) were accounted for the remaining less than 10% market share.

²⁴³ Airline Leader, *supra* note 209.

²⁴⁴ CAPA, "Lion Air has opportunity to accelerate LCC growth in Indonesia after modest traffic gains in 2013" (2014) online: <centreforaviation.com/analysis/lion-air-has-opportunity-to-accelerate-lcc-growth-in-indonesia-after-modest-traffic-gains-in-2013-166898>.

²⁴⁵ Airline Leader, *supra* note 30.

²⁴⁶ Based on seat capacity, Indonesia AirAsia acquires approximately a 23% share compared to 16% for Garuda and 8% for the Lion Group. *Ibid*.

negotiating with a Vietnamese partner to launch a new airlines by 2017. As it keeps ordering a large number of aircraft, Lion Air is predicted to overtake AirAsia as the largest LCC group in Southeast Asia in the near future.²⁴⁷

Meanwhile, the combination of major growing airlines with slow capacity growth has resulted in fierce competition and overcapacity on some domestic routes. Even after the failing prime competitors, such as Batavia Air, Mandala Airlines, and Merpati Airlines, have vacated the market, the competition remains robust. Apart from Lion Air's decision to keep expanding their fleets at a rapid rate, other domestic airlines have curbed their fleet expansion. Indonesia AirAsia, for instance, has cut growth in its fleet, and Garuda Indonesia has rationalized its wide-body fleet plan to deal with the current condition.

By contrast, as far as the international market is concerned, Indonesian carriers seem to fall short in competing against other ASEAN carriers or gulf carriers. Even though its international market has huge potential as the middle class is increasing and tourism is better-promoted, the rest of the Indonesian airlines remain content with domestic traffic. As secondary cities become more poised to grow the aviation market, major Indonesian airlines are now focusing on expanding their regional domestic networks. New point-to-point routes are launched to cater for demand growth, and more services are offered from regional hubs to second or third tier destinations. As a result, most of the domestic airlines are narrowing the competition in the domestic traffic only, but most of the country's inbound and outbound travels are carried out by foreign carriers such as SIA, Tiger Airways, Cathay, Qatar Airways, etc.²⁴⁸

In the air cargo sector, the market is relatively stable with a fractional increase in annual growth rate. Cardig Air, Tri MG Airlines, and Republic Express Airlines are Indonesian scheduled cargo airlines operating seven cargo aircrafts with an estimated capacity of 120 tons, equivalent to an average capacity of 17 tons per aircraft. Garuda, although it does not operate cargo aircraft, is the largest Indonesian airline in terms of the amount of air cargo carried.²⁴⁹

²⁴⁷ Airline Leader, "The 2016 regional outlook at a glance" (Issue 32, 2016) online: <www.airlineleader.com/categories/regions/the-2016-regional-outlook-at-a-glance-263030> .

²⁴⁸ Airline Leader, *supra* note 30.

²⁴⁹ Indonesia Infrastructure Initiative (IdII), "National Strategy for the Implementation of ASEAN Open Sky Policy Stage 2" (Final Report, 2011) online: <indii.co.id/index.php/en/publications/national-strategy-for-the-implementation-of-asean-open-sky-policy-stage-2-final-report>, at 190

Domestic air freight is the largest cargo market segment with a 65% of the total cargo market in 2009, followed by international air freight with a 32% share.²⁵⁰ The inbound traffic of air freight has been largely affected by the currency depreciation suffered by Indonesia, resulting in a lower import demand. The slow growth of national air cargo service comes by no surprise as the global air freight market, particularly in Asia-Pacific, also undergoes similar situation.²⁵¹

A.2. Air Transport Infrastructure

Airport and air navigation system are two fundamental air transport facilities to support the aviation industry. Due to its vast territorial landscape with a rapid growth in air traffic demand, Indonesian government has to maintain hundreds airports and numerous airplanes flying on its airspace.

Based on Minister Regulation Number 69 of 2013 on Airport Affairs, currently Indonesia has 237 airports located between the Indonesian eastern corner (Sabang) and the western corner (Merauke), with 29 among those as international airports. Additionally, there are remaining hundreds airports owned managed by the local government and military. The 25 larger airports, with the majority of the international flight routes, are operated by two state-owned enterprises namely PT Angkasa Pura I and PT Angkasa Pura II. The latter is responsible for the operation of twelve airports in the western regions of Indonesia²⁵² and the former is responsible for the operations of the other thirteen airports, mainly the middle and eastern regions,²⁵³ including two cargo warehousing and one air traffic control center. Since the deregulation era in aviation policy, the government has encouraged more public-private partnership model to maximize the airport operation, notably in the aeronautical facilities such as landing facilities and aircraft storage

²⁵⁰ Ibid.

²⁵¹ IATA, "Air freight growth slowed to 2.2% in 2015" (Press Release No. 3, 2016) online: < www.iata.org/pressroom/pr/Pages/2016-02-03-01.aspx>.

²⁵² Soekarno-Hatta – Jakarta, Halim Perdanakusuma – Jakarta, Kuala Namu – Medan, Supadio – Pontianak, Minangkabau – Padang, Sultan Mahmud Badaruddin II – Palembang, Sultan Syarif Kasim II – Pekanbaru, Husein Sastranegara – Bandung, Sultan Iskandarmuda - Banda Aceh, Raja Haji Fisabilillah - Tanjung Pinang, Sultan Thaha – Jambi, Depati Amir – Pangkalpinang and Silangit - Tapanuli Utara.

²⁵³ Ngurah Rai – Denpasar, Bandara Juanda – Surabaya, Bandara Hasanuddin – Makassar, Bandara Sepinggan – Balikpapan, Bandara Frans Kaisiepo – Biak, Bandara Sam Ratulangi – Manado, Bandara Syamsudin Noor – Banjarmasin, Bandara Ahmad Yani – Semarang, Bandara Adisutjipto – Yogyakarta, Bandara Adisumarmo – Surakarta, Bandara Internasional Lombok - Lombok Tengah, Bandara Pattimura – Ambon, Bandara El Tari – Kupang.

facilities,²⁵⁴ and non-aeronautical services such as ground handling and food court.²⁵⁵ The government also has given a wider opportunity for private parties to operate some airports in Indonesia.

Five international airports have been designated in the ASEAN open skies agenda: Soekarno-Hatta in Jakarta, Kuala Namu in Medan, Ngurah Rai in Denpasar, Bali, Juanda in Surabaya, and Sultan Hasanudin in Makassar. However, these airports are among the busiest airports in Indonesia, especially Soekarno-Hatta, which has served beyond its allocated capacity even before the initiative took effect.²⁵⁶ The slot congestion certainly affects flight safety, increasing delays, and reducing traveling convenience. Hence, the government is now endeavoring to revamp and revitalize the airports building and facilities to cater for more domestic and international traffic.

Nonetheless, based on productivity levels, airports in Indonesia are less productive than those in some ASEAN States. To illustrate, Indonesia's ratio of total passengers to total airports in 2014 was about 192,000 passengers per airport. It is lower than the Philippines (262,000 passengers per airport), Malaysia (475,000 passengers per airport), Thailand (638,000 passengers per airport). Although total registered carrier departures in Indonesia are higher than in neighboring countries, the average number of passengers carried per departure is smaller at 121.2 passengers. The number of carried passengers per departure in Singapore, the Philippines, and Thailand is about 173.9, 137.3, and 136.4 passengers, respectively.²⁵⁷

For better air navigation services, the government established an independent air navigation operator called "AirNav Indonesia" based on Government Regulation No. 77 of 2012 on Public Company Institution for Indonesia Air Navigation Services Provider. AirNav Indonesia has officially provided its services to 26 airports of PT. Angkasa Pura I and PT. Angkasa Pura II since 2013, and additional 168 operational units of DGCA Airports' Service Unit in 2014. Accordingly, AirNav Indonesia has been serving the entire air navigation services in Indonesia which consists of 2 areas control centers, 25 terminal control units, 55 towers, and more than a hundred units of flight information managing ten thousands flights daily.

²⁵⁴ Art 232 para (2) Law No. 1 of 2009 on Aviation.

²⁵⁵ Ibid, para (3).

²⁵⁶ "Major airports undergo massive expansion" (2016) online: < ms.thejakartapost.com/aviation-outlook-2016/2016/06/15/major-airports-undergo-massive-expansion/>.

²⁵⁷ "Weak Infrastructure remains big problem" (2016), online: < <http://ms.thejakartapost.com/aviation-outlook-2016/2016/06/15/74/>>.

A.3. General Regulatory Framework

The primary national legislation in respect of aviation law in Indonesia is Law Number 1 of 2009 on Aviation. The 2009 Aviation Law provides for secondary legislation in the form of Ministerial Regulations and Government Regulations. Given its preamble, The 2009 Aviation Law revoked and replaced Law No 15 of 1992 of Aviation which was considered unsuitable to cope with the current condition, strategic environment change, and requirements of aviation operation.²⁵⁸ It is a comprehensive piece of legislation, consisting of 466 articles covering all aspects of aviation law: from safety and security to economic regulation and carriers' liabilities.

The 2009 Act authorizes the Minister of Transportation to manage all aspects in aviation, including the regulating, controlling, and supervising.²⁵⁹ To fulfill this duty, the ministry has formed a sub-executive unit namely Directorate General of Civil Aviation (DGCA) with the authority to regulate and oversee all aspects of civil aviation in Indonesia.²⁶⁰ DGCA consists of five Directorate Airport Authorities: Directorate of Air Transport, Directorate of Airport, Directorate of Aviation Security, Directorate of Air Navigation, and Directorate of Airworthiness and Aircraft Operation. DGCA notably has a pivotal role to ensure the safety and accessibility of air transport service in Indonesia.

Indonesia, one of the world's fast-developing economies, had once adopted a policy of protecting the flag carrier.²⁶¹ In 2005, the government adopted restrictions first adopted in foreign low-cost carrier (LCC) operations into several major cities, notably Jakarta and Bali.²⁶² If it is true that the protection against competition from foreign airlines with direct access has been given higher priority than the future growth of the tourism industry, Indonesia's big goal to bring in 20 million tourists annually by 2019 might still be a dream.²⁶³ Many also criticize that governmental regulation in air transport has thwarted the liberalization process in the industry, in spite of the fact that deregulation and privatization have been undertaken over the past decades.

²⁵⁸ Point (e) Preamble of Law No 1 of 2009 on Aviation.

²⁵⁹ Art 10 Law No. 1 of 2009 on Aviation

²⁶⁰ Article 450 Law No. 1 of 2009 on Aviation.

²⁶¹ See A. Norman Abend and J. Albert Gomes, "Indonesia Air Transport Policies and Tourism on Bali" in Fachri Mahmud. *Development of International Air Transport Policy* (Jakarta: PT. Kharisma Estetika Primatama, 2002) at 38.

²⁶² Ibid. See also Alan Tan, *supra* note 203, at 290.

²⁶³ "Big plans in store for Indonesia tourist destination" (2016) online: <www.thejakartapost.com/news/2016/11/02/big-plans-in-store-for-indonesia-tourist-destinations-.html>.

In this respect, the following paragraphs will examine to what extent global deregulation affected the policy of Indonesian air transport.

B. The Development of Indonesian Air Transport Policy

To begin, Indonesia has gone through three momentous regimes: Old Order, New Order, and Reformation. Each regime has different political and economic ideology that affects the policy outcome, particularly in aviation industry. To simplify, the development of Indonesian air transport policy in this thesis is illustrated in two major phases: before and deregulation era.

B.1. Pre Deregulation Era

The politics in the Old Order era tended to be socialist where the government played the role both as the actor and entrepreneur in all economic sectors, including aviation. In its first inception, air transportation services were entirely carried out by state-owned enterprise, Garuda Indonesia.²⁶⁴ Until 1965, there were only two airlines, Garuda Indonesia and Merpati Nusantara Airlines.²⁶⁵ Merpati originated from a social-purpose carrier under Indonesian Air Force in November 1958 to serve outlying areas. Both were state-operated, the former was the major domestic and international carrier and the latter being secondary.²⁶⁶

The government, through the Department of Air Transportation, severely restricted the market by strict supervision and rigid domestic regulations, including the regulation of tariffs and pricing,

²⁶⁴ Garuda Indonesia Airways was initially established in 1950 as a State company, which means no separation between the company and the government property, including the capital, profit, and losses. In 1970s the government passed the subsidiary law No. 67 of 1971 concerning Change from State-owned enterprise (PN) *Perhubungan Udara "Garuda Indonesia Airways to Limited Company (Persero)* that changed the status of Garuda Indonesia from a state company to a limited liability company. Under its new status, all of its shares remained under the government ownership but with the separation of property. This government regulation should be read pursuant to Law No. 19 of 2003 concerning State Owned Enterprise. After its first corporatization, Garuda underwent privatization in 2010 by its first IPO at Indonesian stock market. To date, the government of Indonesia is still the major shareholder with 60% of the shares.

²⁶⁵ Merpati Nusantara Airlines was previously named a state-owned enterprise (PN), which later became Limited Company Liability (PT). See *Regulation Concerning Change from State-owned enterprise (PN), Perhubungan Udara Daerah dan Penerbangan Serba guna "Merpati Nusantara" to Limited Company Liability (PT) Merpati Nusantara Airlines (MNA)*, Indonesia Reg.70/1971 (1971).

²⁶⁶ According to Law No 19 of 1962 on the Establishment of State Company "Merpati Nusantara"

routes, capacity, frequency, and even the kind of aircraft operated.²⁶⁷ There was no competition at that time since no other airlines served the market.

Merpati grew quickly to serve the whole Indonesian archipelago and became Merpati Nusantara Airlines in 1969.²⁶⁸ Its successful operation directed a threat for Garuda Indonesia that the airline's chief campaigned to terminate or, at least, restrict Merpati's operations. In 1974, Merpati stopped purchasing jet aircraft and, four years later, sustained heavy financial losses.²⁶⁹ The Indonesian government then decided to transfer its Merpati shares to Garuda, and therefore no direct competition on the main routes sustained.

In the Old Order era, the first Indonesian legislation in air transport was promulgated in the Law No. 83 of 1958 on Aviation. The Act has a simple structure, consisting of 28 articles and divided into 8 chapters. The Act was intended to codify the aviation law enforced in Indonesia from the colonial era to the end of 1950s. It, however, failed to do so since the laws passed by the Dutch administration remained in force though were scattered in some different instruments.²⁷⁰ This domestic aviation act was not completely novel nor original as it was translated and a modification of the No. 118, 1933 Dutch Law of Air Navigation (*Luchtvaart besluit*) and Netherlands Indie Ordinance No. 205, 1934 (*Luchtvaart-Ordonantie*). It could be said the

²⁶⁷ The routes in Old Order era was regulated in the Decree of Minister of Transportation No. T 14/4/4-U concerning Concessionary Authorization for State Company GIA to conduct Flight Operation from Jakarta to Medan, Padang, Palembang, Belitung, Teluk Betung, Kotaradja, and Bengkulu. Decree of Minister of Transportation No. S 8/2/5-Phd concerning the Route Structure of State Company Merpati Nusantara Airlines; Decree of Minister of Transportation No. SK 293/S/1970 concerning Flight Routes determined as the Cross-Border Routes.

²⁶⁸ Merpati operated short international services, with turboprop twin-engine aircraft, to Singapore and Malaysia, to Kuching in eastern Malaysia, and to Darwin in northern Australia. It also operated charter services to the Philippines and even across the Pacific to Los Angeles.

²⁶⁹ Merpati was forced to buy domestically produced IPTN (national aircraft manufacturer) aircraft that was of low quality. This policy affected the company's maintenance cost brutally due to the need to frequently change the spare parts. According to some analysts, from its humble beginning in 1962, Merpati had carved a niche. In 1996, its share of domestic traffic was 38%. Dipendra Sinha. *Deregulation and Liberalisation of the Airline Industry. Asia, Europe, North America, and Oceania* (USA: Ashgate, 2001) at 22.

²⁷⁰ Indonesian civil aviation legislation was originally enacted by the Dutch administration on the basis of transitional provisions. These laws had continued in force until they were repealed.

While the Dutch Law in Air Navigation 1933 and the Ordinance in 1934 were repealed by the time the New Aviation Act was adopted, major Dutch aviation legislation remained in force, among others:

1. Regulation for Air Traffic Control No. 425, 1936
2. Regulation for Inspection of Air Navigation, No. 426, 1936
3. Air Carrier Liability Ordinance No. 100, 1939
4. The Air Quarantine Ordinance, No. 149. 1939

enactment of the Aviation Act of 1958 merely commenced the process of nationalization and consolidation of Indonesia's aviation law.²⁷¹

At the time when the act was adopted, Indonesia had little contact with external institutions and followed a nationalistic commercial policy. As a consequence, the Act did not reflect the possibility that foreign nationals might be permitted to invest in Indonesian enterprises.²⁷² As a translation, the Act was successful, but in other aspects, in particular the consolidation of instruments, it was a failure. Furthermore, this law was inadequate because it failed to reflect or recognize the technical, political, and economic changes as a result of globalization that had taken place at that time.

The socialistic approach was sustained in the market until the government passed law No 1 of 1967 concerning Foreign Direct Investment. The authoritarian regime under Ir. Soekarno collapsed and the political stream changed to a neo-liberal approach, wherein the socialist and liberal ideology was combined. The air transport policy under the New Order set up a limited multi-airlines system, which was composed of state-owned enterprises together with privately-owned companies.²⁷³

Under the New Order era, the Ministry of Communication issued a decision that enabled private individuals to operate aviation business.²⁷⁴ Until January 1976, there were six scheduled airlines operating in Indonesia.²⁷⁵ The two incumbents are given the monopoly rights for the archipelago routes alongside four privately owned scheduled airlines with limited terms of the equipment which they may operate:²⁷⁶

- 1) Bouraq which operates in the region of Java, Kalimantan and Sulawesi;²⁷⁷

²⁷¹ Partanto, "Proposals for Revision of Civil Aviation Legislation in Indonesia" LL.M Thesis. McGill University (1980) at 20-21.

²⁷² The underlying policy of the foreign investment was not recognized in the 1958 Act since the regulation was issued later in 1967 pursuant of the Law No. 1 of 1967 concerning the Foreign Investment Act.

²⁷³ Ahmad Sudiro & Martono, "National and International Air Transport Regulations in Indonesia" (2016) 9 IOSR-JAC, 7 (Issue 3, Ver. I) at 10.

²⁷⁴ Indonesia, *Ministerial Decree Concerning requirements and Provisions Regarding Using Airplanes for commercial Purposes*, Ministerial Decree No.SK 13/S/1971 (18 January 1971)

²⁷⁵ Partanto, *supra* note 271, at 1-2.

²⁷⁶ *Ibid*, at 101.

²⁷⁷ Bouraq Airlines started its first operation on 1 April 1970 as a privately owned company by Jarry Albert Sumendap and in associate with Porodisa, a timber business company. In 1980s, Bouraq was permitted to operate in the Malaysian and the Philippines secondary airports and Singaporean Changi airport.

- 2) Zamrud which operates in the Eastern region of Indonesia;²⁷⁸
- 3) Mandala which also operates in the Eastern region of Indonesia²⁷⁹
- 4) Seulawah which operates in Sumatera.²⁸⁰

Garuda Airways was still functioned as a main carrier to serve trunk lines, while Merpati and other private airlines served as supplementary. Although Ministry of Communication set and controlled all tariffs,²⁸¹ Garuda played the role as the price leader, to which all airlines subjected their ticket price. Garuda was allowed to impose a higher tariff than the private airlines,²⁸² most importantly its first-class tariff which was permitted to be 15% higher than the normal prices for the flights using Airbus aircraft.²⁸³ The privilege was also given to Garuda as the only one carrier which could flew jet aircraft, while Merpati and other supplementary airlines were restricted to operate turbo propeller aircrafts.

Early new order era under Soeharto, Indonesian five-year national plans (*Repelitas*) was introduced. Within the plan, transport was seen as a key to shaping the overall spatial pattern of urban and regional development. Airports and aircraft were given increased priority in the third and fourth *Repelitas* (1979-89). Some capital being invested in heavily subsidized Pioneer (*Perintis*) services, which were designed to provide low-cost access to remote and less-developed areas. Despite the pioneer initiatives were successful to support the transmigration agenda, the services had made little contribution to economic development. As argued by Leinbach, the *Perintis* air services have had a negative impact in that they may be redistributing income to those

²⁷⁸ There is not much information about Zamrud Aviation Corporation. In an undetectable timeline, the airlines flew Douglas DC-3s to the Small Sunda Islands, such as Lombok, Flores, Sumbawa and other regionals that other airlines found either impracticable or less profitable.

²⁷⁹ Mandala Airlines was founded in February 1970 under a military management and at first operated flights between Jakarta and destinations in eastern Indonesia, such as Ambon, Gorontalo, Kendari, Makassar and Manado as a second-tier airline. After several financial problems and almost filled up for bankruptcy petition in early 2011, Singapore-based Tiger Airways through Road Aviation Pte. Ltd. and Saratoga Investama, an Indonesian strategic investment company, rescued the airlines. Subject to Indonesian law, Tiger Airways acquired a 33% stake, while the Saratoga Group owned 51% of Mandala. Tigerair Mandala ceased all operations on 1 July 2014, following the decision of the main shareholders to cease funding the airline.

²⁸⁰ Seulawah Air used to be a military –owned airline, which was taken over by Mandala in 1972. It flew to cities in western Indonesia, such as Banda Aceh, Medan, Padang, Palembang and Pekanbaru.

²⁸¹ Indonesia, *Ministerial Decree concerning Higher Tariff for Garuda Indonesian Airways Then Private Airlines*, Ministerial Decree No.KM 96/PR.303/Phb-84 (1 May 1984).

²⁸² Indonesia, *Ministerial Decree Concerning Domestic Tariff Changes*, Ministerial Decree No.KM 96/PR.303/Phb-84 (1 May 1984).

²⁸³ Indonesia, *Ministerial Decree Concerning First Class Domestic Tariff for Airbus*, Ministerial Decree No.KM 157/PR.303/Phb-83 (1 August 1983).

who already have the most as the enhanced access benefiting only the very small percentage of the population that can afford the fares.²⁸⁴

B.2. Deregulation Era

Major transformation was made during the first 1990s under the pressure of the growing tourism sector. Before, the investment policy in aviation industry was characteristically closed and gave a limited opportunity for the private entrepreneurs. The Indonesian government allow chartered operator to import jet-engine aircraft and to compete in the domestic market, while private operators were allowed to operate on international segments. Garuda, on the other hand, had been largely reoriented towards its key offshore markets. Government control was made through fare and licensing requirement for airline companies. Deregulated domestic services were initially carried out by four main carriers, i.e. Merpati, Sempati, Bouraq, and Mandala, all of which are allowed to operate jet-propeller aircraft.²⁸⁵

The 1958 Act was repealed by the Law No 15 of 1992 on Aviation. The law was issued after Indonesia ratified Chicago Convention, thus acknowledging the adherence of Indonesia to international civil aviation regime. The law has 76 articles, most of which deal with domestic operation. As far as international operations are concerned, the 1992 Act addressed the prohibition for any foreign carrier to carry domestic traffic.²⁸⁶

For Indonesia, airline deregulation helps fulfill a larger goal: to promote the nation's aerospace industry. The government hopes that, by loosening some restrictions, it can accelerate the growth of Indonesia's airlines, which will in turn become major customers for IPTN (*National Airplane Manufacture*), the country's aircraft manufacturer.²⁸⁷

The domestic aviation industry was in jeopardy when the economic crisis hit the country hard in the 1997. Airline companies operating in a domestic market experienced a difficult time because of the astronomical change in the foreign exchange rate brought by the crisis. The demand for air transport was drastically low, thus the government did everything to fix the problem. Not only did

²⁸⁴ Brian Graham, *supra* note 8, at 201.

²⁸⁵ *Ibid.*

²⁸⁶ Art 39 Law No 15 of 1992 on Aviation.

²⁸⁷ Thomas R. Leinbach & Richard Ulack, *supra* note 7, at 241.

the Asian crisis affect the aviation industry and overall economy, it also tremendously changed the regime in Indonesia, leading to the reformation era.

Just a few months after the reformation era commenced, the government enacted Law No. 5 of 1999 concerning the Prohibition of Monopoly Practice and Unfair Business Competition (1999 Act). The law established National Competition Surveillance Commission (KPPU) for scrutinizing the government's monopolistic policies that may jeopardize the market and, consequently, changed the geopolitics in the national aviation industry.

Furthermore, the 1999 Act and the issuance of the Minister Decree No. 11 of 2001 have significantly altered the national aviation policy, by which the authorization procedure for scheduled airline companies and the capacity rule are more simplified. This deregulation invited more competitors to the industry. The number of airline companies tripled from 7 in 1999 to 27 in 2004 as the law allowed the domestic scheduled airlines to obtain an operating license with a minimum of two aircrafts. Garuda was no longer the price leader as the government appointed an independent air carrier association, Indonesian Air Carrier Association (INACA), to fix the tariff.²⁸⁸ The 2001 Ministerial Decree also allowed companies to set their own economy class fare within the upper and lower boundaries. The decree was subsequently amended by the Ministerial Decree No. 81 of 2004 that eventually created a neck-to-neck price competition within the industry and between air transport and rail/sea transport.

These deregulations caused disadvantages to the domestic aviation market and the transport market as whole. The safety standard and service quality were at risk as airline companies competed to lower the basic fare under the ceiling price set by the government. Many old players from New Order era, like Seulawah Airways, Bouraq Indonesia Airlines, Sempati Air, and Indonesian Air Transport, were phased out of the market due to bankruptcy. A similar problem was also sustained by other modes of transportation, as many of the land and sea transport companies incurred financial losses.²⁸⁹ To curb unhealthy competition, the Ministry of Air Transport issued the Ministerial Decree No. KM 25 of 2008. Under the new decree, all scheduled airlines must operate minimum five units of aircraft, of which two are in its own possession and

²⁸⁸ This authority was revoked in 2002 based on the suggestion of the Indonesian Business Competition Supervisory Commission (KPPU).

²⁸⁹ Ahmad Sudiro & Martono, *supra* note 273, at 11.

the others may be leased. The government had to revoke the business permit of the domestic carriers which failed to fulfill this requirement.

After some series of deregulation actions taken through ministerial decrees, the government in the Reformation Era pursued a further relaxation by the promulgation of the Law No. 1 of 2009 on Aviation, which abolished the 1992 Act. This law is applicable for both domestic and foreign carriers conducting the air carriage activities from and/or to Indonesia.²⁹⁰ The 2009 Act followed a philosophy that *it is not necessary to have too many airlines but existing airlines must be able to compete*.²⁹¹ In contrast to this philosophy, the airline companies providing scheduled and non-scheduled air service, air cargo, and charter flights, as well as general aviation, grew rapidly. Inefficient carriers offering scheduled passenger services, however, were kicked out of the market. Some of these included Batavia Air, Adam Air, Tiger Mandala Air, and even Merpati which ever claimed to serve more routes than Lufthansa in the 1960-1970s.

Under the 2009 Act, the government divides the class of domestic operation due to the stipulation of ceiling price and pioneer routes price. There are 319 routes for jet-engine aircrafts, 367 routes for propeller-engine aircrafts, and 132 Pioneer routes. The last route is provided by the government to serve the people in remote areas. These routes are typically unprofitable as they are usually located in isolated and underdeveloped areas. The government offers incentives for the companies willing to serve them, such as new commercial routes, operating cost subsidies, and Fuel subsidies. Air fares for passenger and freight in these routes are determined by government under the Minister of Transportation Decree No.44/2012 about tariffs for pioneer routes.²⁹²

Domestic tariff policies are set according to neo-liberal approach, where economy class tariffs are regulated by the government based on the consumer protection and the fair competition, while non-economy class tariffs are determined by airline companies based on market forces.²⁹³ On the other hand, international tariffs for scheduled passenger and cargo carriers are determined by the bilateral/multilateral agreement ratified by Indonesia.²⁹⁴ In fact, the Indonesian government tends to be protective when it comes to the domestic tariffs regulation. Until the present day, the Indonesian airlines are subject to the upper-tariff limit set by the government, represented by the

²⁹⁰ Art 4 para (b) Law No. 1 of 2009 on Aviation.

²⁹¹ Ruwantissa Abeyratne, *supra* note 200, at 171.

²⁹² OECD, *supra* note 9, at 7-8.

²⁹³ Art 126-128 Law No 1 of 2009 on Aviation.

²⁹⁴ Art 129 Law No 1 of 2009 on Aviation.

Ministry of Communication.²⁹⁵ The government argues that the objective of this tariff ceiling is to protect the travelling public and to guarantee the sustainability of airline's operations in a competitive environment.²⁹⁶

In that sense, domestic aviation industry in Indonesia is still a highly regulated industry. As far as the security and safety issues are concerned, regulations are indeed important to protect the consumer. The government assumed that the major air accidents in the country occurred due to the airlines' race in cutting up their safety cost. However, both airlines executives and analysts argue that the fare differentials only reflect the levels of the airline services, thus there is a little relation, or impact, between setting up the price with the safety improvement. Moreover, compromising safety to improve profitability would never be a sound practice for the airline business, as it would risk its reputation.²⁹⁷

According to Partanto, the deregulation policy as implemented in the US by the enactment of Airline Deregulation Act, is not relevant to Indonesia where the conditions are very different. He perceived that "the nation composed of islands cannot rely on the happenstance of market forces for the maintenance of communications."²⁹⁸ Furthermore, the major airlines are state-owned, and they cannot be permitted to compete as it would be waste of the State's resources. Equally, had they competed with privately owned airlines, their inherent advantages as state-owned airlines would make the competition a sham.²⁹⁹ This argument, however, is at odds with current situations and the trends where public-private partnership model has been adversely applied in the aviation industry. The government no longer has a full ownership over the flag carriers and foreign airlines nowadays can carry domestic passengers through Fifth or Sixth freedom. In fact, to meet the increasing demand of air transport and rapid development of Indonesian airlines, the power to control and govern the industry is slowly but surely transferred to the market forces rather than fully on the government's hand.³⁰⁰

²⁹⁵ Martono & Ariawan Gunadi, *supra* note 221, at 210.

²⁹⁶ *Ibid*, at 212.

²⁹⁷ "Big challenge, great opportunity" (2016) online: <ms.thejakartapost.com/aviation-outlook-2016/2016/06/15/big-challenges-great-opportunities/>.

²⁹⁸ Partanto, *supra* note 271, at 99.

²⁹⁹ *Ibid*, at 99-100.

³⁰⁰ See the Law No. 1 of 2009 on Aviation that regulates the tariffs for domestic scheduled-airlines. Art 126 to 130 stipulate that "the government's intervention on tariffs is limited to regulating the economy class. The tariff for non-economy class is relied on the supply-demand without the government's intervention. As far as the latter is concerned, the government only determines the proportion of the seat capacity, in which the airlines concerned should provide 40 percent of seat capacity for non-economy class and the remaining percentage for economy class."

Furthermore, rigorous regulations imposed by the government more often deter the airline industry to perform to the most of its potential. Even after the advent of liberalization has spread out, the airline companies in Indonesia are still facing various bureaucratic red tapes and high tariffs. Seeing Indonesian's experiences, it is perhaps true that airlines deregulation is nothing but a pseudo re-regulation of the industry to achieve the outcome desired by a country's regime.

C. Indonesia and the Open Skies Agreements in ASEAN

C.1. Indonesian Commitments in the ASEAN Open Skies Agreements

Liberalization of air transport in ASEAN comprises of two fields: soft rights and hard rights.

C.1.1. Soft rights

As of 2016, Indonesia has ratified seven out of nine protocols dealing with the commitments on air transport services under the ASEAN Framework of Air Services. Up to the Eighth Package, Indonesia indicates its commitments in five sub-sectors: i) *Aircraft Repairs and Maintenance Services*, ii) *Selling and Marketing Air Transport Services*; iii) *Computer Reservation Systems Services*; iv) *Aircraft Leasing without Crew*; and v) *Airfreight Forwarding Services*.

The commitments made by Indonesia in the context of ASEAN and the dialog partners³⁰¹ are limited to three sectors: *Aircraft Repairs and Maintenance Services*, ii) *Selling and Marketing Air Transport Services*; iii) *Computer Reservation Systems Services*. Exclusion to the ASEAN – Japan Comprehensive Economic Partnership Agreement (CEPA), Indonesian indicative offer only covers *Aircraft Repairs and Maintenance Services*.

C.1.2. Hard rights

The liberalization of hard rights (or commonly known as traffic rights) in ASEAN is enforced through the ratification of MAAS, MAFLAFS, and MAFLPAS. All of them have been ratified by Indonesia including their implementing protocols. In addition, Indonesia is ready to ratify the protocol granting unlimited Fifth freedom rights in the scope of ASEAN – China Air Transport

³⁰¹ ASEAN dialog partners in Air Transport Agreement comprise of China, Korea, Australia New Zealand, Japan, and India. Exclusion to ASEAN – Japan CEPA, Indonesian indicative offer only covers *Aircraft Repairs and Maintenance Services*.

Agreement.³⁰² Indonesia has prepared Lombok as the point where all designated ASEAN and Chinese airlines can carry Indonesian passengers under the Fifth freedom rights.

With respect to liberalization in cargo services, Indonesia has agreed to grant unlimited Third, Fourth and Fifth freedom traffic rights to other ASEAN Members to access the following points: Pontianak, Balikpapan Manado, Makassar, Biak, Batam, Palembang, Jakarta, Medan, Denpasar, and Surabaya. With respect to liberalization in passenger services, Indonesia has agreed to grant the same traffic rights as the cargo to other ASEAN Members from and to five points: Jakarta, Makassar, Medan, Denpasar, and Surabaya.

Oftentimes, Indonesia was the last ASEAN Member to ratify the AOSAs. The MAAS and MAFLAFAS were signed in 2009, but Indonesia had only fully ratified them in 2011 and 2015 respectively. It even took another four years for Indonesia to ratify the Protocol 5³⁰³ and 6³⁰⁴ of the MAAS that were signed at the same date as MAAS. Indonesia also needed six years to fully ratify the MAFLPAS and its implementing protocols, compared to other countries which mostly took a year after signing the agreement.

This sluggish behavior is justified by the imbalance opportunities that Indonesia may offer and the cost of the AOSAs. Indonesia's tremendous domestic air traffic offers potential to competitors in terms of connecting such traffic to international routes through the Sixth freedom carriage. In essence, Sixth freedom hub operations depend simply on two factors: a geographically strategic "hub" airport in the center of airline routes to serve as a transit stop, and unlimited Third/Fourth freedom rights to operate numerous "spokes".³⁰⁵ As Indonesian carriers do not offer expansive and regular services to Europe and North America, most of the traffic from these countries are largely served by Singapore Airlines through its hub, Changi Airport.³⁰⁶

On the other hand, the result of the single aviation market is anticipated differently by Indonesia. Even though it will generate more tourists coming from and flying to the region due to the improvement of connectivity and quality of air service, it is unlikely that the policy will have a significant impact on Indonesia's ability to penetrate the more substantial world tourism

³⁰² ASEAN and China signed an air transport agreement with two protocols: (1) Protocol 1 (signed in 2011) covers unlimited Third and Fourth freedom traffic rights between any points in Contracting Parties; and (2) Protocol 2 (signed in 2012) covers Fifth freedom traffic rights between 28 secondary points in China and 10 secondary points in ASEAN.

³⁰³ Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Capital Cities

³⁰⁴ Unlimited Fifth Freedom Traffic Rights Between ASEAN Capital Cities.

³⁰⁵ Ruwantissa Abeyratne, *supra* note 200, at 172.

³⁰⁶ *Ibid.*

markets.³⁰⁷ The worst-case scenario is that more Indonesians leave the country rather than the other way around. Moreover, the ASEAN SAM does not have a regulatory infrastructure as the EU does, which makes the ASEAN open skies regime seems like a “free for all”.³⁰⁸

C.2. Indonesian Regulatory Approach to Liberalization in Air Transport

Law No. 1 of 2009 is the first Indonesian law dealing with aviation, by which the notion of open sky is acknowledged.³⁰⁹ At that time, the ASEAN open skies policy was being developed over a period leading up to 2009, and was the subject of the two ASEAN multilateral agreements signed later in the same year.

The law covers both domestic and international aspects of air transport services, including the aviation infrastructures, such as airports, air traffic controls, manufactures, licensing and business permits, etc.

According to Article 90 para. (1), Indonesia adopts the progressive liberalization approach for the enactment of the open sky policies that include foreign carriers. This gradual method is undertaken by, but not limited to, considering the competitiveness level of the national airlines³¹⁰ in concluding bilateral and multilateral agreements with other countries.³¹¹

The subsequent paragraph extends that the agreements concluded must consider the principle of fairness and reciprocity, subject to the national legislation and national interest.³¹² National interest is further specified to include the interest of national sovereignty, the unity of national territory, national economic interest, and the sustainability of national airline companies.³¹³

In the case that Indonesia is bound into a plurilateral agreement, only the country with which Indonesia has a bilateral relationship can exercise its rights under the agreement.³¹⁴ For example,

³⁰⁷ IdII, supra note 250, at 8.

³⁰⁸ Ruwantissa Abeyratne, supra note 200, Ibid at 174.

³⁰⁹ Art 90 para (1) Law No 1 of 2009 on Aviation stipulates that “the liberalization of air transport market toward airspace with unlimited traffic rights (open skies) from and to Indonesia for foreign commercial air carrier companies is undertaken gradually based on bilateral and multilateral agreements and is implemented through mutually-binding mechanism.”

³¹⁰ Elucidation of Art 90 para (1) Law No. 1 of 2009 on Aviation.

³¹¹ Ibid.

³¹² Ibid, Art 90 para (2).

³¹³ Elucidation of Article 86 para (3) Law No. 1 of 2009 on Aviation.

³¹⁴ Art 87 para (1) Law No. 1 of 2009 on Aviation. If Indonesia is the Member of a plurilateral agreement that concludes an agreement with a Third Party, the implementation of the rights will be based on the agreed provision in the agreement.

when Indonesia entered into a horizontal agreement with the European Union, there has to be a bilateral agreement preceding the horizontal agreement.³¹⁵

According to Indonesian aviation law, bilateral agreement is an air service agreement concluded by the government of Republic of Indonesia with one foreign country to become contracting party.³¹⁶ In essence, the function of bilateral air service agreements is to regulate international air transport in order to prevent alleged sector-specific market failures and to generate rents for the national economies by a strategic trade policy approach.³¹⁷

In negotiating an air services agreement with other countries, the Decision of Director General of Air Transportation No. KP 480/2012 stipulates that Indonesia would limit the foreign market access to the 5th freedom, allow multi-designated airlines, relax the frequency and capacity based on the market principle, liberalize the tariff through double disapproval mechanism, allow limited co-terminalization, and allow the charter flight to land at the tourist destination.³¹⁸

A multilateral agreement is an air service agreement that has specific or general characteristic adopted by the government of the Republic of Indonesia with some foreign countries that become the permanent contracting parties.³¹⁹ In general, the government must consider the competitiveness level of the national carriers in signing up for multilateral air service agreements. As one of the Members of ASEAN, the Indonesia's approach is still to restrict the cabotage right and apply a gradual ratification process for any agreements and their subsequent protocols. So far, Indonesia has ratified the MAAS and its two protocols, MAFAS, and the last one in 2016 for MAFLPAS.

The law stipulates that foreign carriers are only allowed to serve the international route from and/or to Indonesia through bilateral and multilateral agreement concluded between the Indonesian government and the government where the carrier is registered.³²⁰ Notably, a multilateral agreement would not automatically grant a foreign carrier to enjoy the Third and Fourth freedom to fly the Indonesian territory even though the nationality of such airline is also the party of the

³¹⁵ Batai Saraswati & Shinya Hanaoka, *supra* note 236, at 2162.

³¹⁶ Elucidation of Article 86 Para (1) Law No. 1 of 2009 on Aviation.

³¹⁷ David W. Gillen, et.al, *supra* note 48, at 40.

³¹⁸ To grant the traffic rights to its counterparts, the government will consider the principle of reciprocity and equality of opportunity, as well as the national interest based on politic, economic, social, culture, defense, and security aspects; national demand for air transport; the party's potential; domestic routes and networking; the potential of local (especially for tourism purpose); and the harmonization between other modes of transportation.

³¹⁹ Elucidation of Art 86 Para (1) Law No. 1 of 2009 on Aviation.

³²⁰ Art 86 Para (1) Law No. 1 of 2009 on Aviation.

agreement. Instead, international service by scheduled airlines from and/or to Indonesia must be undertaken under bilateral agreement between Indonesia and the respective State.³²¹ These international agreements must be drafted in accordance with the national legislation and national interest based on the fairness and reciprocity principle.³²²

This law also allows for the national airlines to cooperate with the foreign carrier in carrying the cargo and passenger for international routes,³²³ on the condition that the local shareholder must own the biggest share (*single majority ownership*).³²⁴

As of 2012, Indonesia has concluded air services agreements with 73 countries.³²⁵ In 2015, the number increases to 75 countries, in which 46 operators from 22 countries have operated in 19 cities in Indonesia³²⁶ and 9 Indonesian airlines operate to 29 cities in 15 foreign countries.³²⁷

It also closely cooperates in the framework of multilateral cooperation in sub-regional levels like IMT-GT and BIMP-EAGA; regional level like ASEAN and APEC (Asia-Pacific Economic Cooperation); and the world level like D8³²⁸ and WTO.

The government, however, allows the adoption of more liberal policy for sub-regional groupings where Indonesia becomes one of the parties (IMT-GT and BIMP-EAGA). This policy is aimed to improve underdeveloped areas within these sub-regions.

As for BIMP-EAGA cooperation, Indonesia adopts multi-designated airlines under the principles: 1) substantially owned and/or effectively controlled; no restrictions on capacity, frequency, and the type of aircraft; allowing for co-terminalization with stop-over right and code

³²¹ Art 86 Para (2) Law No. 1 of 2009 on Aviation.

³²² Art 86 Para (3) Law No. 1 of 2009 on Aviation.

³²³ Art 88 para (2) Law No. 1 of 2009 on Aviation.

³²⁴ Art 108 (3) Law No. 1 of 2009 on Aviation. Foreign ownership for the scheduled and non-scheduled carriers is limited to 49%. See Presidential Decree No. 44 of 2016 on Negative Investment List. The Decree specifies the list of the business opened and closed for the foreign direct investment.

³²⁵ Decision of the Director General of Air Transportation No. KP 480 of 2012 concerning the Road Map of Indonesian Air Transportation. As of 2015, Indonesia has concluded BASAs with 75 countries. See ICAO Journal, Volume 70, Number 2 (2015) ICAO: Montreal.

³²⁶ Medan, Padang, Pekanbaru, Palembang, Batam, Jakarta, Bandung, Solo, Yogyakarta, Surabaya, Denpasar, Mataram, Manado, Banda Aceh, Balikpapan, Makassar.

³²⁷ Hong Kong, the People's Republic of China, Japan, South Korea, Taiwan, Malaysia, Thailand, East Timor, Singapore, Vietnam, the Netherlands, England, Australia, New Zealand, and United Arab Emirates.

³²⁸ D-8, also known as Developing-8, is an organization for development cooperation among the following countries: Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey. This organization was established in 1997 through the Istanbul Declaration of Summit of Heads of State/Government and aimed for economic cooperation in a global level, instead of regional. Notably, civil aviation is one of the areas of cooperation. See their website online: <www.developing8.org/About.aspx>.

sharing arrangement; allowing for airlines cooperation for the route that has not been served by Indonesian carriers, and cabotage restriction. Besides introducing co-terminalization with stop-over right and commercial cooperative arrangements, Indonesia in IMT-GT commits to reduce the parking and landing fee and to harmonize the airport charges.

In terms of doing business, Indonesia is much more liberal, for example to sell and advertise the airlines products. Although Indonesia is quite strict to the substantial ownership and effective control rules, it has adopted multi-designated airlines, double disapproval tariff with some safeguards; and more relaxed arrangement on air freight services. It also allows for the third party code sharing under the condition of Fifth freedom right for the third party's airlines.

C.3. Indonesian Stance toward ASEAN Open Skies

Liberalization of air transport in Indonesia is conducted gradually. The challenges faced by the Indonesian air transport industry include: performance, demand, and legal matters. The performance of national airlines is yet optimal to developing their business scope and enhancing their competitiveness; the potential demand of many cities in Indonesia that have international airport is still low; and the legal apparatus is yet to be integrated. Thus, the Indonesian open sky policy is still limited only on the cities which have high market demand, such as Jakarta, Denpasar, Surabaya, Medan and Makassar.³²⁹

The period of 1999-2000 was the beginning of the aviation liberalization and the starting point of improvement in the industry. Indonesia had experienced a long period when establishing an airline company was a privilege for those who had power and capital. Nonetheless, the result of the advancement did not all turn out well. While passenger traffic and the services increased rapidly, the airlines became vulnerable to bankruptcy and lack of safety control. In early 2000, seven new private carriers were given licenses to operate (i.e., Air Wagon International (AWAIR), Bayu Indonesia Air, Indonesian Airlines, Pelita Air Services, Lion Mentari Air (Lion Air), Jatayu Air and Rusmino Internusa Air). However, existing airlines abandoned important routes as a part of consolidating their positions. Existing carriers have accused the new airlines of selling tickets far lower than market prices.³³⁰

³²⁹ An interview conducted between the Author and the Indonesian Transportation Attache, Mr. Saptandri Widiyatmoko, at the ICAO building on Friday, 4 November 2016 at 11am-1pm (hereafter: *Interview*).

³³⁰ Dipendra Sinha, *supra* note 269, at 22.

The rapid growth was not adequately supported by the improvement of quality. Moreover, the lack of infrastructure often became a significant obstacle for the industry make the best of its potential. Cases such as travel delay or accidents are not uncommon problems of the Indonesian aviation industry, which make Indonesian airlines seem to be ill-prepared for wider competition against foreign airlines. Air traffic has also been adversely affected by natural disasters, such as volcano eruptions, which force airport closure for some time and, consequently, lead to a reduction in inbound demand.³³¹

Irrespectively, the Indonesian government is still keen on promoting liberalization in the air transport industry. The government perceives that liberalization would enhance the opportunities of domestic airlines to diversify their business. It is hoped that this policy will increase the number of foreign tourist. Besides, the government expects that the domestic airlines can enhance their cooperation with foreign airlines, while at the same time, improve their competitiveness.

The Indonesian Attache of Transportation, Mr. Saptandri Widiyanto, stated that the government of Indonesia needs to protect market access and the availability of domestic feeder, not the national airlines. Airlines are merely seen as a tool to pursue the ultimate purpose, i.e. economic development, particularly the national connectivity. The Indonesian government is inclined to focus more on developing the tourism sector by enhancing national connectivity, regardless of the nationality of the carriers providing the service, apparently because the national income from tourism sector is much higher than the airlines can generate.³³²

Thus, it is apparent that Indonesia adopts a pragmatic approach in dealing with liberalization in air transport. Indonesian policy on ASEAN open skies is shaped to be gradual, limited, and reciprocal purportedly due to the imbalance of benefits that Indonesia may gain from the liberalization and the potentials that Indonesia has to offer to its ASEAN counterparts.

D. Analysis and Synthesis

³³¹ The volcanic ash and haze from the eruption of the Mount Raung in 2015 and Mount Kelud in 2014 affected Ngurah Rai International Airport in Bali, through which the biggest number of international passengers are funneled to Indonesia. The airlines must cancel their flights and suspend their operations until the situation returned to normal. "Indonesia volcanic ash causes new Bali airport closure" (2014) online: <<http://www.bbc.com/news/world-asia-33473679>>.

³³² *Interview*

In theory, liberalization will result in increased competition, increased air services, increased frequency on existing routes, enhanced products, increased service quality and lower prices. This, in turn, will lead to an increased opportunity to travel stimulated by the new opportunities. In brief, the results include the accelerated increase of air traffic that stimulates growth in the economy, economic activity, and employment.

However, an open sky policy poses a number of potential risks, especially for Indonesia. As noted above, Indonesia is the largest market in the ASEAN region in terms of having a substantial number of passenger and airports. Such competitive advantage, unfortunately, is not in parallel with advanced technology and management of human resources that has placed Indonesia below the international standard. It is indeed, Indonesian government is super cautious in relaxing the access to its domestic market. The fear is not unreasonable, as the government has learned from experience that there are crucial aspects that must be considered before deregulating the aviation market. There exists ongoing concern that Indonesia's airlines will not be competitive enough to compete with their Southeast Asian counterparts for market share in regional routes.

Indonesian carriers also have a tendency to oppose the idea of air service liberalization through a single market in the ASEAN level. They perceive liberalization is better pursued bilaterally and selectively according to market need.³³³ Through INACA (Indonesian Air Carrier Association), Indonesian carriers lobbied the Indonesian government to postpone the ratification of the open skies agreements.³³⁴ A more liberal agreement is considered unnecessary because current bilateral air service agreements with all Member States suffice the need for all Indonesian carrier operation.

Balancing the needs of social and economic cohesion and the need to support vital air links along the archipelago, as well as the possible requirement to include regional link/public service obligation protection into any changes, may also pose problems. Any relaxation of air service regulation will tend to result in increased service and competition on the most dense routes and reduced and inferior services on thinner but vital links.³³⁵

³³³ Batari Saraswati & Shinya Hanaoka, *supra* note 236, at 2169.

³³⁴ Batshur Gootiiz, & Aaditya Mattoo, "Regionalism in Services : A Study of ASEAN" Policy Research working paper; no. WPS 7498. Washington, (DC: World Bank Group, 2015) online: <documents.worldbank.org/curated/en/616071467987821046/Regionalism-in-services-a-study-of-ASEAN> at 20.

³³⁵ IdII, *supra* note 250, at 16.

Since the ASEAN open skies is also a part of ASEAN Economic Community, the member States need to be aware of the global trends in aviation business and the challenges of market access worldwide. In this regard, Indonesia is compelled to align its aviation policy towards the international phenomena in air transport field.

Indonesian airlines already find it difficult to compete against other ASEAN carriers such as Singapore Airlines and Thai Airways. Both airlines operate aircrafts of a much larger average size than Indonesian carriers, as their operations are primarily long and medium hauls in nature. However, this concern shall not be deemed as the reason to cut off the greater competition promulgated in the AOSAs. Instead, the government should see it as a tool to cater to more international passengers over domestic hubs by the national airlines. Moreover, existing connecting passenger traffic currently using the domestic services of the Indonesian airlines will be improved as more international capacity is added.

Special attention shall be addressed to the connectivity strategy to implement the ASEAN open skies commitments by using Soekarno-Hatta Airport as the main hub. Besides the issue of capacity deficiency, the strategy to secure international connectivity only through the national gateway at Jakarta can result in significant disadvantages to the outlying provinces. Connecting journey via Jakarta might add substantially to the time and cost of the travel that consequently might hinder the development of other provinces. The key issue nowadays is that the underperforming regions, where enhanced air service access could make a real difference to accelerating economic growth, are presently excluded from the planned ASEAN SAM. Meanwhile, the greatest proportionate gain from an open skies policy is to benefit the outlying regions. Hence, whilst opening up Jakarta within the ASEAN region will support economic development at a national scale, there is more to be gained relatively by opening up more remote points which today lack direct links to other ASEAN points or where service is restricted by constraints on frequency within the existing bilateral agreements.

Indonesia may learn from the US experience in the deregulation era. Indonesian government might consider to allow further consolidation to occur in domestic markets, for example through merger. This is a market solution to save the economy when the airline business is at crisis or simply when overcapacity occurs. The combined carrier might have been in a better position to control capacity in the short run, lowering costs through economies of scale, elimination of redundancy, or synergistic sharing between the units of the new company.

Nevertheless, the government should be careful in allowing the airlines to consolidate. There is a possibility that a proposed consolidation between two high-cost poorly managed carriers would end up creating a bigger, higher cost carrier. Moreover, the effect of mergers between carriers with very similar route structures has the potential to severely reduce capacity and competition in certain markets, resulting in higher prices, fewer choices, and lower capacity. Thus, consolidation can be approved as long as the market competition does not diminish.³³⁶

³³⁶ Dawna L. Rhoades. *Evolution of International Aviation: Phoenix Rising* (USA: Ashgate Publishing Company, 2003) at 185-186.

CHAPTER IV

CONCLUSION

In this era, open skies agreements within a trading bloc have been common as one element in free trade or economic integration. The open sky in multi-national scope, or so-called regional open sky, expands the liberalization of air transport more rapidly to the rest of the world, as compared to the bilateral mechanism. It connects the closed-economics and less-developed States to the global market through joint market forces and *en bloc* negotiation. This system conceivably can bridge the exchange of ‘hard rights’ at an international level when world-wide multilateralism is somewhat ambitious.

A. ASEAN Open Skies Agreements in Its Own Way: What does It Envision?

The urgency to create a regional open skies arrangement is also spread out to the south-eastern part of Asia, the home of ten States of the Association of South-East Asian Nations (ASEAN). Moreover, since the majority, if not all, of the ASEAN States have a competitive advantage in the tourism sector, they are more aware of the importance of the air transport sector to be integrated in the ASEAN Economic Community agenda. After inaugurating a series of ministerial meetings and a number of action plans, three open skies agreements were adopted by the Members of ASEAN during 2009-2010 (AOSAs).³³⁷ These agreements aim at providing competitive space for expansion and opportunities for regional air travel.

As far as market access and the nationality rule are concerned, the provisions set forth in the AOSAs are commonly found in the regional open skies agreements adopted in other aviation blocks,³³⁸ especially those in the Yamoussoukro Decision and the Damascus Agreement. These agreements typically govern unlimited Third, Fourth and Fifth freedom to fly in intra-regional routes and allow for the establishment of Community Carriers with economic or regulatory control to be vested in one or some of the Member States or their nationals. The AOSAs, however, accord to the ASEAN carrier unlimited capacity, frequency, and pricing as well as the permission to code-

³³⁷ ASEAN open skies agreements are codified in three instruments: Multilateral Agreement on Air Services, Multilateral Agreement on Full Liberalization of Air Freight Services, and Multilateral Agreement on Full Liberalization of Air Passengers Services.

³³⁸ For example no limited number of frequency, capacity, route, type of aircraft; multiple airline designation; double tariff disapproval; and so on.

share. To this date, all Member States have ratified all of the agreements including the protocols.³³⁹ Later, these AOSAs are intended to facilitate the establishment of the ASEAN Single Aviation Market (ASEAN SAM).

In 2011, an implementing framework for the ASEAN Single Aviation Market (the Implementation Framework for the ASEAN Single Aviation Market)³⁴⁰ was released, supposedly to put more liberal provisions than those that have already been agreed upon in the preceding open skies agreements. This implementing framework reaffirms that single aviation market in ASEAN stops at Fifth freedom traffic rights for the time being. Alas, despite the fact that this conveys the possibility for further liberalization, the discussion would only be held if deemed necessary.

In comparison to the single market in the European Union, ASEAN seems to be more humble and less ambitious. The single aviation market envisioned by them is focused only on liberalizing international links between the Contracting Parties. In fact, Third and Fourth freedoms were generally already granted through bilateral agreements between the ASEAN States. The AOSAs are not concerned with Seventh freedom nor cabotage rights. Moreover, the ASEAN carriers were already able to bypass Fifth freedom restrictions through cross border joint ventures. Interestingly, the agreements accommodate the revolutionary provisions on nationality rules; yet, as a matter of fact, the operation of such airlines would remain uncertain. This milestone is obscured by the accompanying clause rendering the States' discretionary power.

Be that as it may, if open skies is defined as granting unlimited capacity, frequency, and type of aircraft, the AOSAs have illustrated a partial success.³⁴¹ The thing is, the ASEAN SAM has yet to reach its zenith. This argument exhibits three facets:

First, individual interests come first, before common objectives. It is not surprising that the AOSAs fall short to govern the Seventh freedom and cabotage right, because States like Indonesia, Laos and the Philippines are more sensitive to granting the cabotage right to their ASEAN counterparts like Singapore, Malaysia and Thailand. In this regard, the AOSAs correspond to some

³³⁹ <online: <http://asean.org/storage/2012/05/Ratification-status-of-Transport-Agreement-as-of-March-2017.pdf>>.

³⁴⁰ It was adopted during the 17th ASEAN Transport Ministers Meeting (Phnom Penh, 16 December 2011). It states that the key elements of the ASEAN SAM comprise of economic and technical elements. The economic elements include market access, charters, airline ownership and control, tariffs, commercial activities, competition law and policy/state aid, consumer protection, airport user charges, dispute resolution, and dialogue partner engagement. Meanwhile, the technical elements include aviation safety, aviation security, and air traffic management and technical. See Implementation Framework, *supra* note 202.

³⁴¹ Martin Staniland, *supra* note 13, at 133.

sort of an astute compromise made by the ASEAN Members to intermediate their unique challenges and fragmented domestic laws. “ASEAN Minus X Formula” is one of the compromises to allow for all Members to join the bandwagon at any time they feel ready to do so. Besides, while some governments remain conservative on foreign ownership, there is a more relaxed attitude toward control that airline entrepreneurs have been quick to capitalize on, like AirAsia. As long as they obey the substantial ownership and control provision on paper, the States seem to be less concerned as to whom is actually controlling the airline company. This has allowed liberalization to grow roots in reality, despite the formal strict attitude toward foreign ownership stakes.

The pros and cons, however, are still looming on matters related to the Seventh freedom and cabotage. The proponents of this scenario raise the concern that the comprehensive agreement with an open or unlimited capacity between ASEAN and Third Parties’ (Dialogue Partner) would stand to benefit the “outsiders” more than ASEAN, especially in terms of market network and penetration. While non-ASEAN airlines may connect the points within ASEAN from or to their domestic points under unlimited Fifth freedom, ASEAN airlines may not do the same to the points in their Dialogue Partners’ territories due to the cabotage restriction. The inflexibility of the ASEAN airlines to provide intra-ASEAN service under the Seventh freedom would cause an imbalance of valuable traffic. Neglecting this issue would consequently transfer the lucrative benefits of ASEAN market to elsewhere.

On the other hand, some argue that granting Seventh freedom and cabotage rights is equal to losing domestic markets to stronger ASEAN Airlines. This has so many things to do with the competitiveness of national carriers vis-à-vis other foreign/ASEAN counterparts. Those airlines with stronger air links and efficient service operation would likely win the game and bash the flag carrier of the weaker countries, as they can offer cheaper airfares with better services. The States which oppose this idea also fear that it would harm their domestic market in a similar way to how the US open skies policies created a turbulence in theirs.

Nevertheless, the argument against further liberalization would unlikely be sustained for a long time in the near future. Competitive challenges from the global marketplace are inevitable and thus create some pressures to respond. There is a strong argument that the need to rise to global competitive challenges encouraged the recalcitrant Member to move further along the liberalization pathway.

Second, the policy treatment is still based on a case-by-case or state-by-state basis. The ASEAN open skies agreements and the ASEAN-Dialogue Party agreements have entered into force only in those States that have ratified it. Consequently, the AOSAs have been partially implemented in the region. The aversion for supranational institutions allegedly resurfaces in the hesitance to go beyond the harmonization of air traffic procedures. ASEAN does not have supranational institutions which have the power to bind its member States in order to force compliance with liberalization measures that they have agreed upon. Nevertheless, a common policy and negotiating position is important to conduct a negotiation on the basis of common interest as desired in the preamble of AOSAs. The EU's experience suggests that a unilateral conduct would undermine the strength of the Community in international aviation relations.³⁴² Without the institutionalization of a supranational body, it is interesting to see how the ASEAN SAM is forthcoming in the years to come.

Third, the ASEAN SAM is not a failure, but rather a work in progress. The Members' slow motion to fully adopt the single market instruments may be meant as a strategy of gradual or phased liberalization. In the succeeding five-year transport plan issued, the possibility of liberalization beyond the Fifth freedom right was brought up together with provisions for air traffic management, aviation safety, and aviation security as well as the possibility of setting up of institutions to administer the single market.³⁴³ In the area of aviation safety, ASEAN has made good progress in implementing several initiatives including the ASEAN Aviation Regulatory Monitoring System, ASEAN Foreign Operator Safety Assessment, and MRA on Certificates, Approvals and Licenses of Civil Aviation. In the area of air traffic management, ASEAN has also successfully implemented the ASEAN Regional Contingency Plan, Capacity Building Framework on Air Traffic Management and established a database and information sharing system on ASEAN air navigation infrastructure and services.³⁴⁴

³⁴² Jeffrey Goh, *supra* note 92, at 59.

³⁴³ ASEAN Strategic Transport Plan 2011-2015, Jakarta: ASEAN Secretariat (2010).

³⁴⁴ ASEAN Integration Report Jakarta: ASEAN Secretariat, November 2015 http://www.miti.gov.my/miti/resources/ASEAN_Integration_Report_20151.pdf?mid=431, at 65.

B. Indonesian Air Transport Policy towards ASEAN Single Aviation Market: Where does It Stand?

Indonesia is ready to carry out the ASEAN SAM. Legally speaking, Indonesia has been fairly equipped with market-oriented and pro-competition instruments, including the Law No. 1 of 2009 on Aviation and the Law No. 5 of 1999 on National Prohibitions of Monopoly and Unfair Business Practices. These two and other subsequent laws and national work plans are shaping the national aviation industry to ensure domestic connectivity and competitiveness.

With some deregulatory policies in the domestic aviation industry, Indonesian airlines are now expanding rapidly (notably Lion Air and Garuda Airways) and there are more Indonesian citizens fly domestically and internationally. In relation to this, open skies agreements, especially for Indonesia, are a crucial means to facilitate such market expansion and increasing demand. Moreover, as a country that has a heavy reliance on tourism, it would be disadvantageous for Indonesia to restrict the availability and affordability of air services.

Having said that, classifying Indonesia's foreign aviation policy as a regulatory conservative one would be at odds with the significant transformation of its economic paradigm, which is designed to face international liberalization. As far as the AOSA is concerned, Indonesian national plans on air transport have suggested that the exchange of the traffic rights and opening of points at the sub-regional level (IMT-GT and BIMP-EAGA) can be done more liberally than that in the AOSAs, in order to push forward the economic growth in the sub-areas. Moreover, the government is advised to reduce or eliminate excessive controls on frequency, capacity, and pricing when concluding air service agreements. Other terms and conditions, such as multi-designated airlines, double tariff approval, break of gauge, and co-terminalization right, can be accommodated on a case by case basis, in accordance with the principles of reciprocity and national interest.

Amongst many possible factors, the pace of liberalization taken by Indonesia ultimately depends on political deliberation between the government and the airline companies. On one hand, when the airlines are ready to compete with foreign carries, there is little argument that the government would hold back from relaxing the market policy. On the other hand, airlines are not alone. The government also needs to take into account other elements of that support the aviation industry such as, to name but a few, airport infrastructure, air traffic control, safety management and human resources. As Indonesia is still lacking in those aspects, it is plausible that the government is more inclined to inject more capital investments to improve their quality and

availability first before opening up its territory for foreign carriers. Thus, it is unlikely that the government would take more liberal steps in the near future.

C. Recommendations

The common objectives of the single market should be given priority over national objectives. If agreements continue to be negotiated individually and bilaterally, the risk of the fragmentation of air services agreements could result in greater complexity and uncertainty, and, more significantly, lead to a weaker negotiating position with other dominant countries in international air transport.

Alan P. Dobson eloquently notes: “creating the SAM was one thing, making it work was another.”³⁴⁵ Likewise, any effort to create a complete single aviation market would require an enormous amount of political will and commitment to harmonize. It also envisages the need to eliminate differences in the laws, policies, and practices of the countries concerned. This is undoubtedly not an easy process, especially in the region with significantly disparate levels of economic and social development. Arguably, it may benefit ASEAN to establish a supreme institution as a forum to deal with the discrepancies between the Members and to foster the ASEAN SAM efforts.

In the meantime, the ASEAN sub-regional integration efforts (BIMP-EAGA, IMT-GT, CLMV) should not be undermined as a catalyst to foster liberalization in ASEAN. As long as the States move on the basis of their common interest, rather than national objectives, the truly ASEAN SAM is no longer a myth.

For the time being, granting domestic cabotage rights for ASEAN airlines may be considered as a “big-bang” liberalization,³⁴⁶ which is contrary to the Indonesian’ approach that upholds the phased or staged liberalization principle. A radical transformation is unhealthy for a fledgling market, due to its susceptibility to aggressive competition. In a similar vein, since emerging economic States are typically vulnerable to international turbulence (for example: the price of oil), they usually take a longer time to ratify any international agreement that potentially affects national economic development. Moreover, the decision-making process is substantially shaped by the

³⁴⁵ Alan P. Dobson, *supra* note 93, at 186.

³⁴⁶ Jagdish N. Seth, et al, *supra* note 111, at 293.

economic consideration based on the equality of opportunity principle to trade off the domestic access with different market size. More importantly, cabotage is an “exclusive opportunity” for the national airlines to be the domestic feeders “to carry domestic traffic to fill unused capacity into the international hub.”³⁴⁷ By giving foreign carriers direct access to lucrative interior markets, these traditional advantages are potentially diluted.

Those views have a great influence for countries such as Indonesia. However, Indonesia must anticipate the potential threats from the ASEAN and Dialogue Partner open skies agreements. Once it becomes clear that there is intensified competition in the market as liberalization gains momentum, it is disadvantageous to stick to the *status quo*. In this matter, the only way national carriers can increase their competitiveness is by exposing them to a competitive market, not by preserving them in a protected environment.

³⁴⁷ Paul S. Dempsey, “Deregulation, Discrimination & Dispute Resolution In International Aviation: Turbulence In the Open Skies” Doctoral Thesis, McGill University (1986) at 31.

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