Developing ASEAN’s Single Aviation Market and Regional Air Services Arrangements with Dialogue Partners

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Authors:
Ian Thomas
Dr David Stone
Dr Alan Khee-Jin Tan
Andrew Drysdale
Dr Phil McDermott

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The views expressed in this report are those of the authors, and not necessarily those of the ASEAN Secretariat and/or the Australian Government.
EXECUTIVE SUMMARY

The liberalisation of passenger and cargo air services in the ASEAN region is intrinsically linked to the proposed development of an integrated ASEAN Economic Community (AEC) by 2015. It provides an essential component of the transport machinery necessary to facilitate the movement of people and goods between the 10 Member States, as well as the medium for the establishment of closer relations with key external partners.

ASEAN is currently pursuing liberalisation through its Roadmap for the Integration of the Air Travel Sector (RIATS) which culminates in 2010 with the move to unlimited 5<sup>th</sup> freedom rights for passenger services between capital cities in ASEAN. Restrictions on 3<sup>rd</sup> and 4<sup>th</sup> freedom passenger rights between capital cities will be eliminated at the end of this year, together with the further liberalisation of cargo rights, with “open skies” established as part of the single aviation market by 2015.

This report takes ASEAN’s deregulation agenda to another level by producing a framework to establish an ASEAN-wide Single Aviation Market (ASAM) in 2014-15, coinciding with the emergence of ASEC. It contains a draft ASAM Agreement which brings together recommendations on a “best practice” approach to the main elements of the ASAM such as ownership and control, market access, competition policy, state aid, safety regulatory control, the environment and social impact issues.

A Single Aviation Market is defined for the purposes of this report as one where:

- All restrictions are removed for designated ASEAN carriers on the operation of passenger and freight transport and associated commercial activities within the Member States of the ASEAN region;
- A common policy is adopted for user charges, tariffs, competitive behavior and other forms of regulation; and
- Majority ownership and effective control of designated carriers is vested in ASEAN States and or nationals in aggregate.

The AEC Blueprint prescribes timelines for the establishment and implementation of the ASAM Agreement which provide for States to implement ASAM as early as January 2012 if they so wish, with ASEAN-wide implementation occurring during a two-year period between January 2014 and December 2015. At least two States are expected to take up the “early mover” option.

The approach adopted in this report advocates the introduction of the ASAM Agreement as proposed by 2014-15, but phases in the move to a fully liberalised system in relation to certain more contentious market access and ownership provisions to 2022-23 (similar to the EU). These phases and exceptions for early movers are covered in Annexes to the Draft Agreement provided.

This strategy reflects the views of Member States and a pragmatic “base case” scenario strategy, given the range of economic diversity within the region and varying capabilities and resources of the States. It should be emphasised, however, that we do not rule out achievement of the full ASAM provisions by an earlier date (say by 2020), but such a development will depend on the capacity of the States to move forward with the recommended implementation structure at a faster pace. We note that some States have expressed a desire for a more condensed implementation programme.
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The harmonisation of safety/technical systems and airspace management procedures, while outside the scope of the Draft ASAM Agreement, have been addressed in this report. This reflects the importance of facilitating the safe and efficient operation of services across ASEAN within a high growth ASAM structure.

Recommendations are also made on the most appropriate strategies for ASEAN as a whole to address air services relationships with its Dialogue partners, including the EAS States (China, Japan and South Korea) and the European Union (EU), and for individual Member States to capitalise on the liberalised environment.

As well, the report discusses the policy implications of the reforms proposed and provides an analysis of the direct and indirect economic impact of the ASAM.

CAPA Consulting was commissioned by the ASEAN Secretariat to conduct the project resulting in this report. Work began in December 2007, and has entailed a combination of desk-top research and extensive on-ground consultation with each of the Member States on their preferred structure and contents for the ASAM.

The Draft ASAM Agreement contains a number of key initiatives which are designed to significantly advance regional liberalisation beyond the terms of RIATS and establish an operating and investment environment capable of sustaining the rapid growth and potential for economic gain flowing from the ASAM. There are also recommendations relating to facilitation work outside the Agreement.

The recommendations provide for:

(1) Within the ASAM Agreement:
- The creation of an “ASEAN Community Carrier” designation, providing for cross-border ownership and control of airlines by ASEAN nationals;
- Removal of limitations on all 3rd, 4th, 5th and 6th freedom services within ASEAN (consistent with RIATS); and
- The phased introduction of 7th, 8th and 9th freedom access.

(2) Outside the Agreement:
- A programme for a progressive harmonisation of safety/technical regulations, leading to mutual recognition; and
- Harmonisation of ATM procedures within ASEAN, with the aim of improving operating efficiencies, optimising use of available infrastructure and delivering environmental benefits.

This is a highly ambitious and demanding programme of change. In recognition of this, CAPA Consulting is recommending that implementation should be phased in between 2014-15 and 2022-23 with various milestones along the way. We are also advocating that preparatory work and planning for the ASAM and development of the Agreement through to finalisation should commence in 2008-09 to ensure the milestones are achieved.

We propose that, consistent with the requirements of the AEC Blueprint, ASEAN should use the Senior Transport Officials Meeting (STOM) and Air Transport Working Group (ATWG) to coordinate and administer the operations of the ASAM and report to the Air Transport Ministers on progress. ATWG would be supported by two new technical advisory groups, the Air Transport Technical Advisory Group (ATTAG, focused on the harmonisation of safety and technical regulation and ATM) and the Air Transport Services Technical Advisory Group (ATSAG, supporting the development of external relationships and economic regulatory issues).
Study Methodology

CAPA Consulting established a layered work programme which involved consultants working in parallel on various elements between December 2007 and May 2008. Relevant ASEAN documents and earlier reports of studies conducted were reviewed, along with Single Aviation Market agreements for the EU and Australia-New Zealand and other multilateral agreements including the November 2007 draft of the ASEAN Multilateral Agreement on Air Services.

Three members of the team visited the Member States in January-March to discuss issues associated with the structuring and content of the ASAM which were outlined in a questionnaire developed for the project.

Responses to this questionnaire from representatives of government, civil aviation authorities, airlines, airports and tourism were subsequently collated and analysed in a series of workshops in Sydney. From this, an Interim Report was prepared and delivered to the ASEAN Secretariat in April 2008. Further intensive work completed the programme, with the provision of the Draft Final Report on May 12, presentation to STOM in Cebu on May 28 and Final Report on June 12.

This report is essentially structured in two sections:

1. **Intra-ASEAN** – involved with the background to, and recommended development of, the draft ASAM Agreement, and its implications from a policy and economic perspective: and

2. **Extra-ASEAN** – examining priorities for external air services relationships with key markets (the East Asian states and the EU, in particular) and the regional and individual Member State strategies for achieving them.

Background: The Path to Liberalisation

Air travel is one of the designated 11 priority sectors for economic integration within ASEAN. The Action Plan for Air Transport Integration and Liberalisation 2005-2015, which formed the basis for RIATS, provided a framework for the removal of limitations on 3rd, 4th and 5th freedom passenger and freight services within ASEAN, leading up to the establishment of the ASAM. RIATS will reach an important milestone at the end of 2008 with the provision of unrestricted 3rd and 4th freedom services between ASEAN capital cities, to be followed by similar moves in relation to 5th freedom services by 2010.

RIATS reflects ASEAN’s commitment to facilitate the growth of services to provide a platform to stimulate further economic development and trade, promote competition and efficiency and enhance safety and technical standards within the region. However, progress with the roadmap has been hampered by economic diversity between the States and airlines of varying strengths and competitiveness. The move by Singapore and Malaysia to open up the Singapore-Kuala Lumpur route to further competition in February 2008, ahead of the RIATS target date, has strengthened confidence in the process.

Various sub-regional initiatives have emerged in the meantime to accelerate the pace of liberalisation, including the Multilateral Agreement for the Liberalisation of Passenger Air Services (MALPAS) between Singapore, Thailand and Brunei (and, for cargo, Cambodia) and the CLMV Agreement between Cambodia, Lao PDR, Myanmar and Viet Nam. Limited “open-skies” agreements are also in place to spur growth within sub-regions linking neighbouring countries, including the Indonesia, Malaysia and Thailand Growth Triangle (IMT-GT) and the Brunei, Indonesia, Malaysia and Philippines East ASEAN Growth Area (BIMP-EAGA).
Corporate developments have also taken place to push the boundaries of ownership and control restrictions within the region, mostly through the introduction of foreign-driven joint ventures involving Low-Cost Carriers (LCCs) in Singapore, Thailand, Indonesia and, most recently, Viet Nam.

Other liberalisation developments have occurred with mixed success through APEC’s “Eight Options for More Competitive Air Services with Fair and Equitable Opportunity” programme and the Multilateral Agreement for the Liberalisation of International Air Transportation (MALIAT), formed by the US with Singapore, Brunei, New Zealand and Chile.

Single Aviation Market Developments

The development of Single Aviation Markets (SAMs) in the EU and between Australia and New Zealand is reviewed in this report to provide guidance for the modelling of the draft ASAM Agreement. Both have evolved in very different circumstances to ASEAN; the EU as a collective of 27 states underpinned by a centralised regulatory structure, and Australia-New Zealand’s SAM as a bilateral arrangement between two neighbouring countries with a close economic relationship.

In the EU’s case, the SAM was phased in through three packages over a 10-year period from 1987. The first package limited the right of governments to object to the introduction of new fares on intra-EU sectors and gave airlines some flexibility in sharing seat capacity; the second package – adopted in 1990 – gave EU airlines the right to carry an unlimited number of passengers between their home country and another EU member state.

The third package was the most ambitious and far-reaching. Adopted in January 1993, it introduced complete freedom for carriers to provide services across the EU, including from 1997 the freedom to provide domestic services within other member states (i.e. cabotage). With the full implementation of the third package measures, all economic restrictions on flights within the EU were lifted. As a result, all EU carriers can operate air services on any route within and beyond the EU (unlimited 3rd, 4th, 5th, 6th, 7th, 8th and 9th freedom rights).

The initial Australia-New Zealand SAM arrangements, introduced in 1996, allowed for 3rd, 4th, 8th and 9th freedom rights. While 7th freedom rights were limited to all-cargo services for the time being, the two governments indicated their intent to extend 7th freedom rights to passenger services in future. The SAM Arrangements were incorporated and extended in a new open skies agreement that came into force in 2000. In this Agreement, 5th and 6th freedom rights are dealt with under a different category for international services to be operated by “designated airlines”, and incorporating different ownership principles to that for SAM carriers.

This stipulates that carriers must have their principal place of business/place of incorporation in Australia or New Zealand and be effectively controlled by nationals of either country. Under this dual model, SAM carriers must be at least 50% owned with effective board control by nationals of either country; also the head office and operational base needs to be in Australia or New Zealand. Similarly, designated “EU carriers” are required to be majority owned and effectively controlled by EU member states and/or their nationals, and to comply with economic and technical competency requirements.

In relation to competition, the EU’s aviation sector is covered by Community law on anti-competitive practices for all industry with enforcement conducted by the European Commission and, if necessary, through the courts. There are more specific guidelines for state aid as it affects airlines and airports, which essentially provides for aid if it meets regional development objectives and does not distort competition. Competition issues for the Australia and New Zealand SAM, by contrast, are subject to the national laws of each country across all sectors.
Other facets of the EU and Australia-New Zealand SAMs are examined in relation to key components for the ASAM, with recommendations provided on the implementation of “best practice”. As before, we also review other multilaterals, including the draft ASEAN Multilateral Agreement on Air Services.

**Building the ASEAN Single Aviation Market**

The establishment of an ASEAN Single Aviation Market has multiple objectives, and prospective benefits, in terms of furthering ASEAN’s overall economic integration strategy and creating an environment for the free flow of goods and passengers within the region.

In developing a Draft ASAM Agreement, each of the main elements and the key principles underpinning them are considered in the context of these objectives and the experience with other SAMs. The views of the Member States obtained during consultations have also been taken into account.

Recommendations are then provided on the most appropriate course of action, and incorporated under the articles of the draft ASAM Agreement.

The major changes envisaged include:

**(1) Ownership and Control**

The development of ASAM provides an opportunity to radically reform ownership and control rules for ASEAN carriers. Indeed, the introduction of an ASEAN community carrier concept as part of the ASAM in 2014-15 would be wholly consistent with the most progressive SAM arrangements in other parts of the world. Such an arrangement would make it possible for carriers to be majority owned and effectively controlled by ASEAN nationals in aggregate. This would be a significant step beyond the current “principal place of business and effective control” formula, which is already in place in the bilateral agreements of a number of States.

In effect, an ASEAN community carrier clause would allow carriers to attract capital infusions (and management expertise) from more sources across ASEAN, and would provide greater incentives for investors to set up new airlines or recapitalise existing ones. This would benefit the less developed countries in ASEAN which have faced difficulties in raising sufficient domestic capital for their carriers.

However, States initially need only adopt the new ownership/control structure if they wish to or perceive advantage in doing so. Furthermore, while we are recommending that the ASEAN carrier clause be introduced by 2014-15, the proposed move to a common approach within the region should be phased in.

This model allows for the traditional “substantial ownership and effective control” requirement to continue to exist in the interim, as long as a State applies it only to its home carriers.

At the same time, the State involved should not object to other ASEAN carriers reflecting a more diverse ASEAN-based ownership/control structure. This “dual track” position, while not ideal within the ultimate goals of a SAM, reflects the pragmatic realities within ASEAN. In the longer term, we see such an “opt out” provision to be inconsistent with the objectives of a truly single aviation market, and therefore recommend that States ultimately eliminate such restrictions. If ASEAN were to truly embrace the concept of a single aviation market (akin to the EU’s), there should be a common ownership/control requirement (i.e. a truly community requirement) applicable to all carriers. A suitable timeline for such a goal would be around the year 2020.
In the meantime, we would recommend Member States’ move from the “substantial ownership and effective control” clause to the “principal place of business/incorporation” criterion. Effective regulatory control would remain with the designating State. By 2020, all States should have embraced this formula. This would be wholly in line with global trends.

As for “effective control”, the ASAM can provisionally allow for nationals of the designating State to form the majority in the board (and/or to stipulate the Chairman and/or the CEO to be a national), even as majority ownership can be spread among ASEAN interests. This arrangement should also end by 2019-20, when effective economic control should be reposed in the hands of ASEAN nationals taken in aggregate.

### Summary of Recommendations for Ownership/Control

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<thead>
<tr>
<th>Ownership/Control</th>
<th>Recommendation</th>
<th>Implementation date</th>
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<tbody>
<tr>
<td><strong>Phase 1</strong></td>
<td><strong>Introduce ASAM Community Carrier clause:</strong></td>
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<tr>
<td></td>
<td>Based on principal place of business/place of incorporation and effective regulatory control by designating State</td>
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<td></td>
<td>Majority ownership and effective control can reside with ASEAN States/nationals in aggregate</td>
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<td></td>
<td>States can opt-out for their home carriers and retain substantial ownership/effective control</td>
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<tr>
<td></td>
<td><strong>Community Carrier clause fully recognised</strong></td>
<td></td>
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<td></td>
<td>Substantial ownership/effective control option for home carriers is phased out</td>
<td></td>
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<tr>
<td></td>
<td>Majority ownership and effective control can reside with ASEAN States/nationals in aggregate</td>
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<tr>
<td></td>
<td>Effective regulatory control, principal place of business/incorporation remains with designating state</td>
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<tr>
<td><strong>Phase 2</strong></td>
<td><strong>Implementation date:</strong></td>
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<td>2014-15</td>
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<td>2019-20</td>
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(2) Market Access

As noted, the existing ASEAN sectoral programme provides for a progressive shift to unlimited 3rd, 4th and 5th freedom rights for passenger and cargo services between all ASEAN cities by 2014-15. In our view – and that of the Member States - the ASAM should move beyond that to a wholly-liberalised environment consistent with the EU where few, if any, barriers exist to service development.

On that basis, we are advocating the following recommendations:

- The introduction of an explicit provision for unlimited 6th freedom operations in 2014-15, given that such operations are essentially 3rd/4th freedom flights and are already widely used within the region;
- Unrestricted access to 7th freedom routes within ASEAN for all-cargo operations (also from 2014-15), providing an opportunity for additional freight capacity to help lift exports;
- A phased removal of restrictions on charters by 2019-20;
- Introduction of 7th freedom access for passenger services in 2014-15, initially only on unserved routes but moving in stages to unrestricted operations by 2022-23. While such rights are rare in agreements, they are available in the EU and the potential exists for significant economic benefits through increased passenger/tourist travel for the relevant cities and States. This is also consistent with the move to an ASEAN community carrier definition;
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- Provisions for cabotage (8th, 9th freedom), also phased in between 2014-15 and 2022-23. ASAM should again embrace the philosophy of liberalisation, albeit in a manner that minimises disruptions to incumbent carrier operations and yields net benefits for a particular State.

While 8th freedom flights are likely to attract opposition from many States keen to protect their domestic carriers, we see their value in supplementing and developing domestic sectors. However, we recognise that some safeguards will need to be applied during the transitional period.

That is why we recommend the inclusion of 8th freedom access in 2014-15 only involving domestic legs that are not being served.

By 2019-20, the 8th freedom route restrictions should disappear, but on condition that the minimum published economy fare charged by the foreign carrier for the domestic sector must be no less than the lowest available market rate. This protects incumbent national operators from other operators marginally pricing the “add-on” legs of flights.

The other freedom relating to cabotage, 9th freedom access, is also addressed in the ASAM. While 2014-15 is probably too early for this to take place, we recommend that 9th freedom rights should be allowed in 2020. However, States will retain until 2022-23 an “opt out” provision enabling them not to grant these rights if it is believed that to do so contravenes the national interest. Our approach to cabotage recognises that many domestic routes are “thin” and unprofitable for their incumbent operators. Indeed, some of these routes are operated as public service obligations. If a foreign carrier can mount these flights at their own financial risk, there could be benefits all around. Consequently, the provision of domestic services by foreign carriers should not be dismissed at the outset as being necessarily detrimental to local carriers and consumer interest.

**Summary of Recommendations for Market Access**

<table>
<thead>
<tr>
<th>Market Access</th>
<th>Recommendation</th>
<th>Implementation date</th>
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<tbody>
<tr>
<td><strong>Phase 1</strong></td>
<td>Unrestricted 3rd, 4th, 5th and 6th freedom rights between all ASEAN cities for passengers, cargo</td>
<td>2014-15</td>
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<tr>
<td></td>
<td>Unrestricted 7th freedom rights for all-cargo operations for all cities within ASEAN</td>
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<td></td>
<td>7th freedom access for passenger services on unserved routes</td>
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<td></td>
<td>8th freedom access for passenger services on domestic legs between city pairs unserved by direct flights</td>
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<tr>
<td></td>
<td>Unrestricted charter operations allowed on unserved routes or any other route subject to approval</td>
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<tr>
<td><strong>Phase 2</strong></td>
<td>7th freedom access extended to city pairs between capital cities within ASEAN</td>
<td>2019-20</td>
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<tr>
<td></td>
<td>8th freedom access allowed between all city pairs within ASEAN subject to minimum pricing rule</td>
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<td></td>
<td>9th freedom access allowed; States can opt-out if desired</td>
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<td></td>
<td>Charter restrictions removed</td>
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<tr>
<td><strong>Phase 3</strong></td>
<td>Restrictions removed on 7th, 8th and 9th freedom operations for passengers and cargo in ASEAN</td>
<td>2022-23</td>
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(3) Harmonisation of Safety/Technical Regulations, ATM Systems

As with the EU, the establishment of the ASAM gives rise to opportunities to further progress with harmonisation of aviation regulations and systems. This has the potential to raise standards of safety and technical regulation across ASEAN and develop an integrated airspace system capable of efficiently handling the anticipated high growth in movements generated by the ASAM. For this reason, we are recommending that well-defined programmes should be put in place to progressively harmonise the currently fragmented regulatory regime and ATM operating procedures to meet the challenges ahead.

Our view is that, unlike the EU’s centralisation plans for aviation regulation and ATM, ASEAN should maintain responsibility for these functions with the national providers through the harmonisation process. The lack of a homogenous structure, as well as issues of sovereignty and varying standards of provision within the region, makes an EU-style approach untenable.

We propose that the initial harmonisation tasks in relation to regulation would be undertaken by the Air Transport Technical Advisory Group (ATTAG), with a focus on Air Operator and aircraft certification, and flight crew and engineer licensing, as well as the development of a mutual recognition instrument (2008-09 to 2014-15).


ATTAG would also be responsible for harmonising ATM procedures and developing a regional approach to airspace coverage, which ultimately would lead to system interoperability by 2022-23. The ATM programme would also concentrate on upgrading to satellite-based technology to ensure efficiency is optimised.

The potential benefits from a more closely aligned upper and lower airspace structure are considerable, particularly as the growth inherent with the ASAM places pressures on airport and airspace capacity.

Summary of Recommendations for Safety/Technical and ATM

<table>
<thead>
<tr>
<th>Harmonisation</th>
<th>Recommendation</th>
<th>Implementation date</th>
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| Safety/technical regulation - Phase 1 | Responsibility remains with designating State  
First phase of harmonisation of regulations complete:  
a. Air Operator Certifications;  
b. Aircraft certification/airworthiness;  
c. Flight crew and engineer licensing.  
Also development of mutual recognition instrument | 2014-15 |
| Safety/technical regulation - Phase 2 | Second phase of harmonisation complete:  
a. Aerodrome certification  
b. Air Navigations Services (safety);  
c. Other regulations  
First stage of mutual recognition of regulations | 2019-20 |
| Safety/technical regulation - Phase 3 | Move to full mutual recognition of regulations by ASEAN States | 2022-23 |
| Air Traffic Management - Phase 1 | Responsibility remains with national providers  
Move to harmonise airspace procedures; development of regional approach | 2014-15 |
| Air Traffic Management - Phase 2 | Full harmonisation of airspace procedures | 2019-20 |
| Air Traffic Management - Phase 3 | Achieve interoperability of ATM systems for integrated airspace within ASEAN | 2022-23 |
(4) Other Key Recommendations

The Draft ASAM Agreement contains other articles relating to a raft of recommendations concerning important issues such as competition law and policy, state aid, dispute resolution, tariffs, airline commercial opportunities, the environment and social issues.

Consistent with the approach taken for this report, we have opted for the most liberal outcome possible in terms of tariffs and commercial opportunities, removing all restrictions other than one or two exceptions associated with ground handling and “wet leasing” arrangements.

The approach to competition was hampered by the absence of a defined ASEAN-wide policy in this regard, and the fact that only a handful of States have established their own policies. However, the draft ASAM Agreement provides underlying principles in relation to aviation drawn from ICAO. Ultimately these principles may need adjusting to align them with an all-sector policy of the ASEAN Economic Community.

The provisions incorporated in the proposed Agreement both for competition issues and state aid are largely built around the universally accepted principles of ensuring a fair and equal opportunity for designated airlines to compete, and the elimination of all forms of discrimination or unfair competitive practices.

In the event of any complaints in this regard, as with a number of other issues, they can be dealt with initially by consultation or, if that fails, referral to the Senior Economic Officials Meeting through the ASEAN Enhanced Dispute Settlement Mechanism.

Similarly, we have recommended that state aid (subsidies, other forms of state aid and/or protection of carriers) should be allowed if this is necessary: (1) to meet public service obligations to its remote or isolated communities; or (2) to enable the airline to operate national or international services that would otherwise be economically non-viable. Such aid should not be granted on a discriminatory or preferential basis, and the nature and term of the aid and protection should be made public.

The global focus on aviation’s role in the environment demands that this be properly addressed in the draft Agreement. As such, we have adopted ICAO’s recommended approach concerning aircraft noise (also used in the EU), which advocates reducing noise at source through certification and standards, noise abatement procedures, land use planning and management and, as a last resort, operating restrictions.

Emissions policy is still in its formative stages globally. Reflecting this, we have not specified provisions in the Draft Agreement, but recommend that consideration of options for regimes to reduce emissions and other measures be referred to the proposed Air Transport Technical Advisory Group (ATTAG) for further review. This also will enable examination of ICAO’s suggested approach to an emissions trading programme, and its applicability to ASEAN.

We also recommend that Air Transport Services Advisory Group (ATSAG) should review options for consumer protection measures in conjunction with the airlines, IATA and ICAO to ensure that the structure and terms of any provisions are appropriate, and that they can be viably enforced in an ASAM environment. ASEAN’s proposed Coordinating Committee on Consumer Protection should also be consulted in relation to the development of measures for the air travel sector. The EU’s regulations in this regard have not proved entirely effective, and additional considerations needs to be given to other options or means of strengthening enforcement.
Importantly, social impact issues are also provided for in the draft ASAM Agreement. Principles recommended in relation to this include maintenance of the equality of rights and opportunities in the workplace; gender non-discrimination; and prospects for the transfer of skills and resources between Member States to enhance efficiency of service provision.

**Summary of Recommendations in Other Areas**

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<thead>
<tr>
<th>Recommendation</th>
<th>Implementation date</th>
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<tbody>
<tr>
<td><strong>Commercial Opportunities - Phase 1</strong></td>
<td></td>
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<tr>
<td>Removal of restrictions on all activities, except:</td>
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<tr>
<td>a. Ground handling - should be contestable unless there</td>
<td>2014-15</td>
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<td>are pre-existing agreements</td>
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<tr>
<td>b. Wet leasing - subject to designating State complying with</td>
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<tr>
<td>ICAO standards</td>
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<tr>
<td><strong>Commercial Opportunities - Phase 2</strong></td>
<td></td>
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<tr>
<td>Move to full contestability of ground handling at all airports</td>
<td>2019-20</td>
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<tr>
<td>within ASEAN</td>
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<tr>
<td><strong>User charges</strong></td>
<td></td>
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<tr>
<td>Introduction of common policy on airport/ANS user charges</td>
<td>2014-15</td>
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<tr>
<td><strong>Tariffs</strong></td>
<td></td>
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<tr>
<td>Move to no approvals, no filing</td>
<td>2014-15</td>
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<tr>
<td><strong>Competition Law &amp; Policy</strong></td>
<td></td>
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<tr>
<td>Agreement provides for designated airlines to have fair and</td>
<td>2014-15</td>
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<td>equal opportunity to compete</td>
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<tr>
<td>Introduction of unfair practices clause</td>
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<td>Action to be taken against discrimination, anti-competitive</td>
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<td>behaviour</td>
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<td><strong>State Aid</strong></td>
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<tr>
<td>Limits state aid and protection to non-economically viable/public service routes</td>
<td>2014-15</td>
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<td>Agreement provides that this should be transparent and non-discriminatory;</td>
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<tr>
<td><strong>Consumer Protection</strong></td>
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<tr>
<td>No specific provisions in draft Agreement; recommends further</td>
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<td>study of options</td>
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<tr>
<td><strong>Dispute Resolution</strong></td>
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<tr>
<td>Adoption of ASEAN Enhanced Dispute Resolution Protocol</td>
<td>2014-15</td>
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<tr>
<td><strong>Environmental Provisions</strong></td>
<td></td>
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<tr>
<td>Introduction of ICAO-based approach to aircraft noise</td>
<td>2014-15</td>
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<td>Further study recommended in relation to regimes for reduced emissions</td>
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<td><strong>Social Provisions</strong></td>
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<td>Requirement for equality of rights and opportunities for men</td>
<td>2014-15</td>
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<td>and women and non-discrimination</td>
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<td>Pursue opportunities where possible for skills transfer between</td>
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**Analysis of the Economic Impacts of the ASAM**

As part of this report, CAPA Consulting provides a high level assessment of the direct and indirect economic impacts of the ASAM, particularly as they relate to air service and city pair development, competition between hub airports and tourism.

Our analysis established that substantial economic benefits should accrue to ASEAN nations through liberalisation under the ASAM.

Based on studies of other regions and markets, these can be estimated conservatively as exceeding US$1 billion per year when fully implemented. A comparison of the States suggests that these benefits will accrue in different ways according to the level of development within tourism and the economies generally.

To gain and build these benefits within individual States requires that the aviation infrastructure is in place, and can be developed to create opportunities for growth and cope with the consequences.
Increased airline capacity will come from a combination of start-up carriers, especially low cost carriers on existing main routes; the “thickening” of city pair services as competition is introduced on growing routes where today monopolies maintain high yields and limit traffic; and the introduction of new routes or pioneering, by both start-ups and by incumbent airlines diversifying their service offerings. These opportunities for airline growth will be facilitated by the relaxation of restrictions on ownership and by a gradual breakdown of protective practices surrounding State-owned or flagship airlines. The effect will be both to allow new operators into the market and to encourage existing operators to be more innovative.

The increasing differentiation of routes, the proliferation of hub-and-spoke and point-to-point services, and more innovative scheduling will be supported by a greater variety of medium-haul twin jet configurations which will facilitate fine tuning of fleets to particular route needs.

Enhanced airport connectivity will result from an increasingly differentiated airport and route structure involving:

- Expansion of services associated with the principal hub airports, both in terms of hub-and-spoke movements (domestically and within the wider region) and in terms of movements across hubs to non-ASEAN nations throughout the world;
- The emergence of secondary hubs which distribute traffic to a growing number of points within ASEAN or sub-regions; and
- The proliferation of small to medium size international airports servicing specialist leisure markets, often resort focused. These airports may serve specialist or LCC operators.

The full realisation of benefits from ASEAN will require the emergence and development of this structure at all levels. As more point-to-point connections are established within the region, so they are likely to feed traffic up through this hierarchy. The success of the primary hubs will be influenced by their connection both to secondary hubs and to a range of single point origins and destinations.

The External Dimension – Strategy for Engaging with Dialogue Partners

The “extra-ASEAN” section of this report examines how ASEAN in the liberalised environment created through the ASAM’s development should engage with Dialogue Partners and other markets outside the region. We propose strategies both for the establishment of relations with the EAS states as an initial priority, and for ASEAN as a whole, as well as consider the position of the individual Member States.

The report first examines the extent and nature of aeropolitical relationships between ASEAN and eight key markets, including the EU, EAS states, the US, India, other South Asia, the Middle East, Oceania (Australia/New Zealand) and smaller markets. It reviews the scope of services and seat capacity; economic, trade and tourism linkages; and air services agreements.

ASEAN’s arrangements with external partners are extremely important to the economies of the region. Of the 5.21 million weekly seats operated internationally into and out of Member States, 52.3% relate to intra-ASEAN routes and the other 47.2% to markets outside the region. In terms of flight numbers, the balance is much more heavily in favour of intra-ASEAN with 69.2% of weekly frequencies within ASEAN. Services by non-ASEAN carriers to/from ASEAN Member States comprise, on average 36.2% of total weekly ASEAN seats - around half of the capacity operated by ASEAN airlines - and 6,168 flights.

On balance, the EAS represents the most significant opportunity for ASEAN, as reflected by the already extensive trade and aviation ties between the region and the ASEAN Plus 3 countries China, Japan and South Korea.
This reinforces the views of ASEAN States and the priorities given by ASEAN to the establishment of external air services agreements with its Dialogue Partners.

Individual ASEAN States, in particular Singapore and Thailand, have moved in recent years to secure very liberal bilateral and regional relationships with the EAS, especially China.

The trend will only gather momentum as closer ties are sought with the potentially huge growth offered by mainland China and Hong Kong. As an immediate priority, China is the most likely candidate for the development of a Common Aviation Area similar to that being established by the EU with surrounding states.

The focus on the EAS should not detract from other opportunities with the EU and emerging markets such as India and, to a lesser extent, the Middle East. Any relationship with the EU, however, is likely to be unbalanced until the full development of ASAM is complete and ASEAN is in a position to negotiate as a bloc (assuming this achievable as a future goal). The US also offers great potential for development.

**ASEAN Strategy for Forging External Partnerships**

As part of the progressive development of ASAM, it is envisaged that the region’s aviation relations with third countries would become an important priority for the purpose of expanding market opportunities. To this end, an external strategy will be needed to engage third countries and regions effectively.

In considering how ASAM can be extended to other countries or regions, the experience of the EU should be considered. With the successful establishment of the EU's single aviation market, the European Commission is now actively developing closer aviation relations with neighbouring countries with the objective of creating a common aviation area with these countries by 2010. This is over and above efforts to forge “horizontal mandate” agreements with individual third countries.

As far as ASAM is concerned, the “ASEAN plus X” approach is preferred by most Member States and it is a more realistic option to engage third countries and regions, particularly in the immediate term when ASAM is not yet fully developed. Fully-fledged extension of the ASAM to third countries would entail those countries having to accept all the benefits and obligations of the ASAM, including opening up market access on ASAM’s terms. In this regard, a full expansion of ASAM to include non-ASEAN countries should probably be thought of as a longer term goal.

**Extending ASAM to the EAS**

The immediate priority is the EAS, especially given that ASEAN is already in preliminary discussions with China on a Regional Air Services Agreement. Japan has also shown interest in engaging ASEAN, and there is every prospect for discussions to begin soon with Japan and also Korea.

The advantages of an alliance between ASEAN and the EAS countries are tangible:

- Greater access to two markets with combined populations of more than two billion, and double digit annual high growth in air travel (particularly China and Korea);
- Building on the already close economic, trade and cultural ties between many ASEAN States and the EAS; and
- Strengthening integration within the Asian region, and prospects for the creation of a common aviation area similar to that being pursued by the EU.
Member States, however, are firmly opposed to any straightforward extension of the ASAM to incorporate the EAS. There also may be inherent risks in moving too soon in this direction, before the ASAM is fully developed.

These concerns include:

- In the absence of 7th freedom rights being freely available within ASEAN, any agreement providing only for unrestricted 3rd/4th freedom services may unduly advantage EAS carriers which would gain access to all ASEAN States (whereas ASEAN airlines would be limited to routes between their respective States and the EAS country); and

- If 5th freedom rights were traded, States closest to the most attractive EAS propositions (the ASEAN Plus 3 countries) may be reluctant to agree to open 5th freedom rights with third countries. This may see them providing, for example, 5th freedom traffic into and out of the EAS to carriers operated via their States from more southerly States.

The only way ASEAN carriers can balance the third country carriers’ natural advantage is to mount 5th and 7th freedom operations to that third country through/from another ASEAN Member State. This provides another argument for accelerating the pace of 5th and 7th freedom relaxations within ASEAN.

Thus, any ASEAN agreement with the EAS would have to move beyond just unlimited 3rd/4th freedom rights to cover 5th and (more importantly) 7th freedom operations as well.

Recommendations

We recommend that a phased approach be employed vis-à-vis the EAS states, with a time-frame beyond 2015 set for the more far-reaching objectives.

**Phase 1 (2014-15):** An “ASEAN Plus-X” arrangement should be secured with the individual EAS states offering unlimited 3rd/4th freedom rights. As such, the EAS states would become “associate members” of ASAM. Baseline market access and ownership/control principles could be extended to the EAS, while still leaving room for individual negotiation of specific rights.

At the same time, specific market access negotiations (e.g. 5th and 7th freedom rights) could still be conducted separately outside the framework of ASAM. The next critical step is to liberalise 7th freedom passenger rights within ASEAN. This should preferably be concluded by 2020, at least in relation to capital cities.

**Phase 2 (by 2019-20):** ASEAN should begin to negotiate a common aviation area package incorporating reciprocal 5th and 7th freedom access with EAS countries as a package. This coincides with the proposed completion of the ASAM and consequent lifting of all restrictions on 5th and 7th freedom access within the region.

Negotiations with the individual EAS states can and should proceed immediately in the next few years in parallel with the ASAM’s own development. There is no reason why ASEAN should have to wait for either its own single aviation market to emerge before engaging, for example, the ASEAN Plus 3 states of China, Japan and Korea on an individual basis.

The development of a trilateral grouping between China, Japan and Korea could slow the process of engagement with ASEAN, as this grouping would first need to reach a common position before engaging with the region on a bloc-to-bloc basis.

**External Strategy for ASEAN**

We believe it would be premature for ASEAN to adopt a “horizontal mandate” approach by 2015, let alone establish a common institution to represent all Member States in re-negotiating bilateral air services agreements with third countries.
Yet the region cannot afford inaction, and some phased moves toward full liberalisation ought to be taken in developing its external relations.

Given that the entire process (as demonstrated by the EU itself) is necessarily gradual, it may not be unrealistic to envision an ASEAN “horizontal mandate” approach by 2019-20, entailing – as a first step - the replacement of nationality clauses in bilateral agreements with third countries with an “ASEAN community carrier” clause.

Indeed, if a consensus for an ASEAN community carrier concept has been reached by 2019-20 (with the necessary agreement on community ownership and control), it would be a logical next step to reflect this in aviation agreements with third countries. In the process, it should be remembered that market access and traffic rights may not be so easily altered. Here, the EU experience suggests that this can only be achieved progressively.

ASEAN Member States will first have to agree on a common negotiating position with third countries, and possibly on a common negotiating body as well.

Recommendations

After considering the various issues associated with ASEAN’s external relationship policy, we recommend the following phased approach:

• Phase 1 (2009): ATWG (through ATSAG) should develop a common external policy and joint negotiating body. This is expected to take some years to achieve and, in the meantime, the States would continue to negotiate and expand upon their individual bilateral and regional air services agreements;

• Phase 2 (2020): Introduction of a “horizontal mandate” for the proposed ASEAN community carrier clause which would replace nationality clauses in bilateral agreements with third countries and/or regions; and

• Phase 3 (2023): Agreement by the States on a common negotiating position for external relationships, with a joint ASEAN body handling negotiations. This would provide for the establishment of Common/Open Aviation areas with third countries and/or regions.

Approaches for Individual States

In the meantime, it is important to think about the strategies that individual ASEAN countries should adopt to ensure that they fit within the overall ASAM strategic framework while optimising opportunities to develop their own carriers’ route network and their inbound tourism industry.

We believe that it is critical that all ASEAN Member States should be fully committed to a phased timetable for the liberalisation of the aviation industry. In particular, this report has identified the following goals as critical:

(i) The relaxation of ownership/control of carriers and the recognition of the ASEAN community carrier concept; and

(ii) The progressive relaxation of market access rights, particularly 7th freedom passenger rights not just within ASEAN borders, but from ASEAN to third countries under bilateral agreements.

At the same time, it is inevitable that individual Member States will continue to liberalise aviation relationships with third countries, as well as among themselves, in a bilateral manner. The motivation for these strategies is clear, namely to: enhance the route network and market penetration for their carriers; increase inbound tourism and business traffic; and further enhance the hub status of their gateway airports.
From the perspective of external relations, the ASAM process should thus recognise that individual ASEAN States have the incentive to liberalise and engage with third countries at a faster rate than is prescribed by the common process.

As long as such action is not inconsistent with the grouping’s fundamental objectives, this should be allowed. However, the reality of aeropolitics is such that if the grouping does not act as fast as desired, individual States would argue for the right to move earlier if this is not inconsistent with the overall objectives. It is not necessarily just the most developed States that might argue for early action.

The least developed states would also benefit from an early relaxation of ownership/control rules, in that they would find it easier to raise capital from the region for the establishment of new carriers or the restructuring of existing ones.

Member States with no established international carriers such as Cambodia and Lao PDR would also find it in their interest to relax market access rules (e.g. 3rd, 4th, 5th and 7th freedom rights) to enable foreign carriers to bring in the tourists.

In short, a differentiated strategy that respects individual autonomy while keeping faith with the grouping’s strategic framework is a practical response to the reality of economic diversity among Member States.

Conclusions

With the establishment of the ASEAN-wide Single Aviation Market by 2014-15, the region will embark on a programme of fundamental change towards the creation of an integrated sector linked by common policies, regulations and systems. The reform agenda prescribed by this report’s recommendations and enshrined in the draft ASAM Agreement is designed ultimately to achieve these objectives over an eight-year period to 2022-23.

We do not underestimate the scale of the challenge entailed in realising the milestones set here, nor the complexities involved in balancing the needs of an economically-diverse region with the realities of an unconstrained market and the inevitably volatile operating environment inhabited by airlines. However, we have sought to provide an implementation schedule which takes into account these variables and their implications by phasing in rather than imposing wholesale change.

The protracted experience of the EU, more than anywhere else, in driving together a cohesive single aviation market gives cause for caution in an undertaking of this nature. While open market access for the member states was accomplished in 10 years, the establishment of a centralised safety regulator and a “Single European Sky” for Air Traffic Management are still elusive despite some progress in this regard.

Unlike the EU with European Community laws, ASEAN is approaching the ASAM from the considerable disadvantage of not having a regulatory infrastructure already in place together with established laws for competition policy, state aid, consumer rights and other areas. The proposed ASEAN Economic Community is not due to come into being until 2015, the same year that the ASAM is introduced.