

ASEAN Single Aviation Market*

1. Introduction – Growth in Tourism and Aviation, Open Skies

1.1 World Aviation Industry Post 9/11

Aviation Industry analysts predicted that with the events of 11 September 2001 (9/11) and the growing alarm for terrorism, aviation would experience a downturn for the medium term.

Very few predicted that a year later, tourism would surpass Information Technology as the world's largest industry, and with this growth a new hope for aviation. Also, the rise in the need for quick delivery in logistics also became a contributing factor. World aviation traffic grew between 2001 to 2003 at an average of 14% per year despite previous predictions the day after 9/11.

Another development that contributed to growth in the aviation industry is the move towards a more liberal aviation and economic policy among countries.

Surprisingly, the United States (prior to agreeing to open skies) was seen before by European States as protectionist, initiated between 2002 to 2006 more than 28 multilateral and bilateral agreements that provide for open skies (5th Freedom Rights Chicago convention see Appendix 1) and even full seventh freedom cargo rights.

With this move by the United States, and similarly the creation of single market in EU and ANZ, there is a growing trend to move towards partial or full open skies implementation. Island states with no air flag carrier of their own have long practiced such policies and have lately seen increased air traffic.

1.2 The ASEAN Market

In the ASEAN region + Brunei, Singapore and Thailand are among the two top countries with a strong growth and presence in the world aviation industry. They are followed by Malaysia which recently became ASEAN's top tourist destination since 2002 debunking Thailand.

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The strong presence of aviation in these three countries may be attributed to their firm commitment on policies that promote tourism development. This strong correlation between tourism and air travel have pushed these governments to strengthen coordination and development efforts between the two sectors in their governments.

It must also be mentioned that these four countries are some of the countries who entered into open skies arrangements with the United States.

However, majority of the countries in ASEAN have not signed any open skies agreement with any country or even among themselves.

In the recent ASEAN summit, and concluding STOMs (Senior Transport Official's Meeting), moves have been made to study carefully the benefits of moving towards a single aviation market or open skies with-in ASEAN.

Proponents point out that a statistical survey shows that there is a low frequency of 5th freedom operations conducted within ASEAN, making Traffic Rights less of a problem in the process of integration. This argument is very true, adding to the fact that short haul operations are rendered unviable as seen in airline operations.

For ASEAN, the European Union (EU) and Australian-New Zealand (ANZ) models for aviation market integration may not be viable at the moment. There are greater issues involved such as the Regulatory Capacities of each country and their respective readiness to accept liberalization.

1.3 Philippine Aviation Market Developments

Contrary to world trend, the aviation industry in the Philippines has been sluggish. Between 2001 to 2005, average passenger growth rate has been less than five percent as opposed to the years 1996-2000 which averaged more than five percent a year.

Although operations of the country's national flag carrier have contracted over the last ten years, they are slowly recovering and posting positive earnings.

The Philippine aviation industry is not all gloom, new airlines have emerged, which would hopefully turn a more responsive and dynamic role in serving the passengers.

It must be noted that over the last 15 years, the Philippine

Government tried to spearhead a civil aviation sector reform program.

The first landmark was in the 1990's when monopoly on scheduled commercial air operations was broken with the entry of Grandair, subsequently followed by Air Philippines, Cebu Pacific, SEAIR and Asian Spirit.

There were two major developments that encouraged growth of new airlines. First, domestic routes were opened by the government economic regulatory agency for aviation, the Civil Aeronautics Board (CAB). Second, fare structures adopted less stringent policies on domestic routes.

In 1998

During the Ramos administration, International Airline competition was promoted. The Policy by which air agreements are formulated was changed. Before, the Philippine International Air Service Policy reflected Philippine Air Lines (PAL) as the sole national airline and sought to negotiate solely on the basis of benefits to PAL. The approach now being introduced is to consider the "value to Philippines" on every air service agreement. (EO 219 series 1997)

2. INFLECTION POINTS IN PHILIPPINE AVIATION

2.1 Changing view on Aviation as a Catalyst for Growth and the Rise of Budget Airlines

In previous years, the policy on the development of air infrastructure was preferred to cities with a strong population base and industry. Due to their cost, developing an international airport in a provincial tourist area was seen as a wrong investment as compared to a city which serves as a provincial center or regional economic center.

Aviation traffic trends changes this development myth. World aviation statistics reveal that on the average roughly 70% of air passenger travel are for tourism purposes. Tourists have become discriminating in their flying habits, in the sense that they prefer less stops, they prefer to land in airport of destinations and less transfers.

This aviation trend encouraged the development of international airports in areas such as Phattaya and Phuket. The development of a multiplicity of international gateways, this expanding market, is another source which encourages a more liberal skies policy.

Those areas previously perceived as unviable routes, are becoming viable for airlines to operate. Take for example Clark Airport. There is a growing air travel demand from Casino Junket Operations and Golf recreation. An airline which undertook a market study determined that operations at Clark was not viable due to its proximity to Manila. However, two international airlines now profitably operate in Clark.

Another development suddenly on the horizon is the growth of budget fares and budget airlines in the Philippines. Budget airlines are widely accepted in Europe (Ryan air, Budget Airlines) and the United States (ValueJet). What is surprising is that three local carriers (Cebu Pacific, SeAir, and Asian Spirit) have started experimenting with budget fares.

A budget airline truly becomes realizable only when government re-structures its Air Tariff system. It has been the common view that it is the affluent who rides airplanes, however as operating costs of airlines are being rationalized to cater to a wider market, taxes should also be rationalized.

2.2 ASEAN Single Aviation Market Preparing a Roadmap

There is a growing push to reap the win-win formula of an open skies policy among ASEAN countries for its obvious economic benefits.

“Open Skies policies are successful because they have gone hand-in-hand with airline globalization. By allowing air carriers unlimited access to points in the signatory countries and unlimited access to intermediate and beyond points, Open Skies agreements provide maximum operational flexibility for alliance partners. Open Skies agreements also have provisions that facilitate code-sharing and other cooperative relationships between carriers. Under a bilateral Open Skies agreement, any carrier could establish code-sharing alliances with any U.S. carrier and thereby market service to any point in the United States by flying to the U.S. gateway and using the equipment of their U.S. partner airline to reach the final U.S. destination. Partner carriers would gain options for entering into code-sharing alliances with airlines of a third country for service to the United States.” (Association for Asia Research - AFAR)

In a recent paper “Preparing ASEAN for Open Sky”, an accelerated program is suggested to be adopted by 2012 to adopt unrestricted 5th freedom within ASEAN.

Among the models that may be adopted for implementation are the EU and the ANZ’s Single Aviation Market program (SAM).

The Philippines would have to contend with the following trans-national issues: liberal criteria of airline ownership and control; full liberalization of third, fourth and fifth freedom traffic rights; capacity and tariffs will be decided by the airlines; airlines entering into cooperative arrangements; commercial access to ground handling services; elimination of state aid to national airlines; safety net and safeguards mechanism to ensure sound competition; common rules governing airline operations, airline liability, airline customer protection, air safety and security, slot allocation; common war risk insurance scheme. (See Appendix 2 for details)

2.3 Avoiding the Perils of Aviation Liberalization

When the Philippine Civil Aviation undertook initial economic liberalization to break the monopoly in scheduled commercial flights in the early nineties, the sector was not prepared for its new found freedom. In a span of 10 years the aviation traffic doubled and the Air Transportation Office (ATO), which was responsible for safety oversight found itself lacking in capability. The lack in qualified personnel to undertake safety surveillance measures posed a serious threat to the development of the aviation industry. In 1997, the International Civil Aviation Organization and Federal Aviation Administration conducted an International Aviation Safety Assessment (IASA) and found several inadequacies with ATO in its Safety Surveillance Capability. The Philippines was downgraded from Category I to Category II. This downgrade had economic implications, such that Philippine registered carriers were not allowed to expand or service new international routes. Likewise, foreign registered carriers were discouraged and made to pay higher insurance payments for flying into the Philippines which was then rated Category II in the ICAO IASA. Largely, this also meant that Philippine carriers had to pay higher insurance premiums which meant added burden to operating costs of even domestic routes.

Taking on an accelerated program of open skies or single market, without changing current safety regulatory institutions may again lead to a 1996 scenario.

In an open skies scenario the Philippines should be concerned about the ability of its air safety division to maintain the required high standards of flight safety supervision in the light of its increased work load resulting from the introduction of new technologies on aircraft, growth in the number of air operators, aircraft, and licensed personnel.

In 1997, the ATO envisioned a program called Civil Aviation Sector

reform and Institutional Strengthening Program. The nature of the program called for an integrated law to be passed by Congress that shall make the government body in tune with world current developments such as open skies, and “free flight”.

However, roughly eleven years have passed and not one single reform on this agenda has been made. No legislation has passed, and as it is, ATO still lacks recommended check pilot to industry ratio.

The required industry policies shall be discussed in Section Four.

3. Policies Attuned to the Times

3.1 Government’s General Policy

For the last 15 years, the DOTC, ATO and CAB have declared a policy promoting the economic deregulation, and the decentralization and devolution of infrastructures, in civil aviation. The government adopted this policy to attune Philippine aviation to the world trend of open skies; that fewer restrictions lead to more development.

In the area of devolution and decentralization of infrastructures, there is a growth of non-ATO controlled airports such as Subic, Clark, Cebu, and Davao, while previously Manila was the only commercial airport not owned by the ATO. Infrastructure devolution and decentralization is another area that paves the way for open skies. The creation of Airport Authorities and secondary gateways makes it easier for airlines to directly communicate and negotiate with the approving authorities for flight scheduling as opposed to the previous bureaucratic red tape of a central approving authority.

Economic deregulation in Philippine aviation has occurred through the further reduction of domestic price controls and eliminated stringent route licensing for domestic air service. However, the CAB has withheld the further opening up of international air services market to readily reflect the concept of “reciprocity and value to the Philippines” rather than to PAL in the negotiation of air services rights.

The economic liberalization of the domestic market has resulted in increased domestic traffic since 1997. In prior years to 1997, the international inbound traffic to Manila enjoyed a higher figure than domestic inbound traffic (international 7.2 MPPA versus domestic

6.2MPPA), but after the opening of domestic routes there is more inbound domestic traffic in Manila than international.

This policy statement drafted 15 years is still relevant today. There is a snail pace motion to truly turn this policy into a reality, A review of the changes in aviation would reveal that they remain still a policy and implementation schemes of the ancient regime of monopolistic and bureaucratic central government are still the driving forces in the many decisions taken by the regulatory agencies.

3.2 Policy Statement versus Actual Economic Regulation

One test case for determining how consistent and faithful the government has been on economic regulation is the Air Services Agreement. Air Services Agreements between States is a traditional method for governments to regulate the aviation market. Why is government regulating, and, for whose benefit is the government regulating? In the Manual for the Regulation for Air Transport (ICAO doc 9626), it is reflected that the principle for such regulation lies in the vision to provide for equal opportunities among airlines between different countries. And for whose benefit: the primary case would be in behalf of the consumer, but to the extent that representing governments also look for benefits that would affect their country as a whole and give protection to their flag carriers.

With the idea of equal opportunity in Air Services Agreements, reciprocity became a by-word. For every frequency of flight allowed to a foreign carrier the local carrier is also allowed an equal amount of market share to passenger traffic and cargo to the second country.

It would seem an easy rule to follow. But what if there was a case when there is more passenger demand and the local carrier cannot service half of the demand? In this scenario, you ask the question, should the government allow the carriers of the second state more frequency for the benefit of the consumers? On the other hand, should the government allow only a maximum number that can be serviced by it local carriers?

When Philippine Airlines downsized its operations in 1998 from 65 aircraft to 14, this was the scenario of the Philippine Aviation Market. In routes with a good passenger and cargo volume such as Taipei, Hong Kong, Singapore and Tokyo, the Civil Aeronautics Board (CAB) was faced with this question.

One case in point is the year 2000 Air Panel negotiations between Taipei and Manila, where the two countries could not agree on the traffic volume because Taipei was negotiating for more seats when

its local carrier could not service the volume. The CAB even went to the point of negotiating that Taipei airline can have more seats provided that a portion of its Gross Income on those flights goes to the Philippine carrier. The dispute was not resolved for a year, so flights between Manila and Taipei were not available to the more than 250,000 Overseas Filipino Workers in Taipei.

This stand taken by the CAB, to protect more its local carrier rather than service its passenger reflect the old regime's view to protect the industry, and does not really reflect the general policy statement of DOTC, ATO and CAB itself, "reciprocity and value to the Philippines" rather than to PAL.

The old view (prior to 1995), that Philippine international air routes were considered as the domain of PAL should be changed. Air Routes should be treated like Air frequencies, they are public domain. And if not adequately served, the government may award or grant them to another entity which may appropriately serve the public requirements.

3.2 Open Skies – The Philippine Experience

In 2001, the Philippines had a first experience on the benefits of open skies when it adopted an "Open skies" policy on Clark Airport.

From a previous traffic of roughly an average of one hundred (100) commercial flights a year roughly five thousand passengers, traffic grew to five hundred flights a year or fifty thousand passenger. Two airlines immediately operated in Clark with destinations to Kota Kinabalu, Singapore, and Kula Lumpur.

However, despite the growing traffic at Clark, and its obvious economic benefits to serve Clark as a growing tourism area, the government has decided to end Open Skies policy at Clark by 31 December 2006. The undisclosed culprit for this policy regression was the competition it posed on Philippine Airlines which does not even service Clark.

The Philippines could have taken the Clark Model as a controlled experiment to deal with the issues of Open Skies, which seem inevitable by 2012 as proposed in the STOM last year.

Clark was merely a secondary gateway. The 2012 scenario would include primary gateways. Such an accelerated program would mean the government technical safety difficulties and economic competitive issues for local carriers.

4. RECCOMENDATION: Need to Implement Civil Aviation Sector Institutional Strengthening Program

The paradigm on how business views Open skies must be made clear. Like any program of liberalization, there are economic benefits. The experiences of almost all documented bilateral open skies have been successful both for consumers and corporations. It would be wrong to say Open Skies is inevitable, the Philippines can refuse to join the ASEAN Single Aviation Market (ASAM), but it has to realize that reciprocity of barriers will be made, and the Philippines may lose even its small presence.

The argument on ASAM is therefore not a matter of a yes and no, but a matter of when. When is not really a matter of projected time, but a state of well being in the Aviation Industry, this means policies must be direct in the fact that every implementation is consistent, rules are fair, and approval processes are stipulated.

Preparations and concrete steps must be taken on the different areas of Aviation.

The following are recommended:

4.1 Open Skies Gradual Program

Within the next 2 years, one or three secondary gateways may be encouraged to adopt an open skies policy within ASEAN. Clark, Cebu, and Davao would be appropriate test cases in Luzon, Visayas and Mindanao.

Although, uni-lateral open skies within ASEAN in these airports would mean no reciprocity, a local airline with initiative entering into an alliance with the airlines flying into these secondary gateways may still gain some benefits in areas such as ground services and other aviation supports.

While this experiment is in-phase, an oversight team should be established to document aspects in the areas of:

- Airline Dynamics
- Cross Industry Effects
- Passenger Behavior, Frequency Statistics and Topography
- Price and Tariff Sensitivities
- Safety Regulation Issues

Another option would be to sign a two year bi-lateral open skies agreement with one ASEAN country such as Thailand or Singapore which has a healthy population of Overseas Filipino Workers. However prior to signing such a treaty, the Philippine ATO must undertake steps to upgrade its safety oversight capabilities.

4.2 Re-engineering Existing Government Structures

If there is any entity which needs to be reformed prior to any bilateral open skies agreement, it would be the government technical and economic regulating agency or the Air Transportation Office and the Civil Aeronautics Board which was created through Republic Act 776 in 1952.

The following are the key areas for reform:

- **Corporatization of the Technical Regulator, the ATO** – A legislative agenda should be made to re-structure the ATO into an independent authority with fiscal autonomy. It shall be responsible for planning and implementing functions in the areas of Air Safety Enforcement in flight operations and airport inspections, Air Traffic Services, Air navigation Services, Aeronautical Information Services, and the conduct of flight Calibration. Airport Development and Management should be devolved from the ATO so that it will be a consistent regulator. All airports shall be merely assessed and inspected by ATO for ICAO compliance on Standards and Recommended Practices (SARPs). On the other hand Air Navigation facilities shall remain within the jurisdiction of ATO due to some regulatory nature of Air Navigation Services.

By turning ATO into a corporatized body which shall enjoy fiscal autonomy, it will have the ability to hire Pilots to conduct Air Surveillance in competition to market rates. Currently, there are less than 20 organic Check Pilots to conduct Air Safety Checks to more than 5,000 licensed Pilots. This ratio may place the Philippine aviation sector in a bind when open skies is adopted in 2012.

The following would need to be rationalized within ATO

- **Debtor rectification, Financial Management and Balance Sheet Re-structuring** – The creation of the new ATO would need to start with a clean slate, assets would need to be transferred and loans assumed by the national government. The current ATO operates under traditional government cash accounting procedures which rely on annual budgets, an accrual-based

accounting system would need to be established now that ATO is corporatized. Self sufficiency in operations must be undertaken.

- **Safety Regulation** – Over the last decades, countries have re-structured their civil aviation with the common theme of separating the service areas and safety regulation; however, other countries have opted to devolve only airport services and lump air safety regulation and air navigation. Thus the issue for the Philippines is to provide adequate attention and resources in order to acquire the appropriate personnel exempted from Civil Service Rules and pay rates, and bureaucratic procedure of a government agency.
- **Tariff Reform** – Based on ICAO cost recovery guidelines, ATO would require its Air Navigation Charges to be increased being the lowest in the region. This will lead to self sufficiency.
- **Human Resource Training and Development** – The current Civil Aviation Training Center (CATC) must be revitalized. Since its funding from UNESCO in the early 1980s, much development is needed to put it at par with the training Center in the region. This will form an important backbone in modernizing Philippine Aviation and gearing it towards open skies.
- **Economic Regulation** – For administrative convenience the economic regulator and the technical regulator must be embodied into the same organization. It is also envisioned that this role may have to be redefined as it will slowly diminish as a world trend. It would need to establish minimum regulations on passenger protection, assist the technical regulator in evaluating management competence, and coordinate with the Department of Foreign Affairs in the negotiation of Air Service Agreements.
- **Devolution of Airport Development and Management** – In recognizing that Airports are economic hubs and are profitable, the creation of government Airport Authorities is encouraged. A clear example would be Manila International Airport Authority. ATO would then be merely in charge of determining airport compliance to ICAO SARPS.

4.3 Re-structuring Economic Regulation – Preparing Local Carriers

The second area which would require reform would be how the government is treating the Aviation industry. Here are some aspects that need some support to prepare Local Carriers

- Aviation Tax Reform – The primary care and push which may be granted to local airlines to prepare them for open skies would be a Tax Reform Agenda. This would require legislation. It must be considered that the nature of the type of people who avail of the services of Air Travel has changed. A tax reform if not a tax break would be helpful
- Access to Cheap Sources of Funding – Although a subsidy is not really helpful or encouraged, there may be some sources of cheap funding which the government may have (i.e. National Development Corporation has a China Fund worth US\$2 Billion which until now has not yet been allocated).

4.4 Integrated Approach in Developing Tourism and Air Infrastructure

Since 1995, the Philippine tourism objective was to reach 4 million foreign tourist arrivals. In 1995, foreign tourist arrivals were at 1.8 million. More than ten years later the figure has only grown to 2.2 million foreign tourist arrivals.

It is not surprising that tourism has not reached the 4 million mark, considering that the government has not also made an integrated plan to at least double the capacity of its premiere gateway which is Manila. In 1995, the Manila airport had traffic of seven million passengers while it was built for a capacity of 4.5 million passengers per annum.

On the other hand, Thailand and Malaysia which envisioned an aggressive growth on tourism doubled the capacities of their primary gateways consistent with their tourism programs.

Integration of airport development into the Department of Tourism is not necessary, but a close and consistent coordination is what is required. Similar to the structures of Malaysia, Thailand and Singapore, a representative from Tourism is consulted and has an imprimatur on airport developments. Congressional Legislation is not required, an executive order mandating the participation and consultative approval of the Tourism Department will suffice for the purpose.

APPENDIX 1 FREEDOMS OF THE AIR

First Freedom of the Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State or States to fly across its territory without landing (also known as a **First Freedom Right**).

Second Freedom of the Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State or States to land in its territory for non-traffic purposes (also known as a **Second Freedom Right**).

Third Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down, in the territory of the first State, traffic coming from the home State of the carrier (also known as a **Third Freedom Right**).

Fourth Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State to take on, in the territory of the first State, traffic destined for the home State of the carrier (also known as a **Fourth Freedom Right**).

Fifth Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State (also known as a **Fifth Freedom Right**).

ICAO characterizes all "freedoms" beyond the Fifth as "so-called" because only the first five "freedoms" have been officially recognized as such by international treaty.

Sixth Freedom of The Air - the right or privilege, in respect of scheduled international air services, of transporting, via the home State of the carrier, traffic moving between two other States (also known as a **Sixth Freedom Right**). The so-called Sixth Freedom of the Air, unlike the first five freedoms, is not incorporated as such into any widely recognized air service agreements such as the "Five Freedoms Agreement".

Seventh Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e. the service need not connect to or be an extension of any service to/from the home State of the carrier.

Eighth Freedom of The Air - the right or privilege, in respect of scheduled international air services, of transporting cabotage traffic between two points in the territory of the granting State on a service which originates or terminates in the home country of the foreign carrier or (in connection with the so-called Seventh Freedom of the Air) outside the territory of the granting State (also known as a **Eighth Freedom Right** or "**consecutive cabotage**").

Ninth Freedom of The Air - the right or privilege of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State (also known as a **Ninth Freedom Right** or "**stand alone cabotage**").

Source: *Manual on the Regulation of International Air Transport* (Doc 9626, Part 4)

APPENDIX 2

The main provisions of the 2002 SAM (Single Aviation Market – Australia & New Zealand) agreements are:

- Australian and New Zealand Airlines are able to operate unrestricted services across the Tasman and beyond to third countries as well as domestic services in each country.
- Australian and New Zealand are able to operate dedicated freight services to third countries using seventh freedom rights.
- All services will be operated to and from designated international airports (customs, immigration and quarantine restrictions are not affected by the agreement).
- Airlines will make commercial decisions on the number of services they operate and the destinations they serve. Government approval for airfares is not required.
- Domestic competition laws apply to the airlines of both parties.
- Australia and New Zealand mutually recognize air safety approvals.

Nine Areas of the Proposed ASEAN SAM:

1. Liberal criteria of airline **ownership and control**. There is a general consensus that the so-called “principal place of business” test is a more liberal approach than the traditional notion that ownership and control should lie in the nation or the state of designation. This issue was extensively discussed at the 2003 ICAO Liberalization Conference, and the conference made a clear recommendation that states should move to the “principal place of business test” (PoB) in both making and accepting designations. It is observed that states are sometimes for liberal in accepting PoB designations than they are in making them, or in writing the test into formal agreements.

Several of the ASEAN states including Myanmar have PoB designation agreements. For example, the airline known as Myanmar International Airlines is itself seen to be controlled by Singapore interests even though it is domiciled in Myanmar.

This concept should be adopted. It will facilitate industry consolidation and lead to a reduction in the need for multiple cross-border shareholding which lead to both confusion and increases in costs through more complex regulatory procedures and requirements.

2. Full Liberalization of Third, Fourth and Fifth Freedom **Traffic Rights** wholly within ASEAN. The low level of 5th Freedom operations conducted within ASEAN by ASEAN carriers indicates that there should be no problem in an unrestricted regime of 5th Freedom rights between ASEAN states. It is recognized that some concerns have been raised about the possible (and desirable) inclusion of Thailand into CLMV because of the disparities of economic and aviation industry size. However, such a situation, staged (if necessary) should lead to a development of traffic where none now exists, because there are no cabotage services. It is agreed that cabotage may be a step too far for ASEAN, however, it is observed that, like intra-ASEAN 5th freedom rights, there is unlikely to be much use of such a facility, even if it were to exist, largely because point to point and hub feeding flights are much more profitable than low frequency domestic services with the complexities of CIQ avoidance that cabotage flights have. The market prefers high frequency, quick turn around, domestic flights. The issue of ownership and control of a purely domestic airline impacts upon the cabotage question. It should be noted that Australia allows a 100% foreign ownership of a domestic airline, or thus “cabotage” by investment is possible.

5th Freedom services with third countries are to be regulated by relevant air service agreements. The high level of 3rd country fifth freedom service within ASEAN generated by the bilateral processes of obtaining rights wholly or partially outside of ASEAN has meant that whilst consumers have a high level of choice, the airlines of ASEAN, on some routes, appear to be negative impacted.

3. **Capacity and Tariffs** will be decided by the airlines. The policy of having airlines decide capacity and tariffs should be supported. Governments in general are unable to enforce tariffs. However, where only two carriers serve a route, the tariffs should be set independently and not in concert.
4. Airlines may enter into **cooperative arrangements**. Whilst in principle allowing airlines to enter into cooperative arrangements is supported, a qualification needs to be added to the extent that arrangements may not be competitive and should not be encouraged where there only two carrier on a route. The existence of 5th and 6th Freedom competition may be very supportive of competition and may allow such arrangements to

be established. There may however be very thin routes where such arrangements are essential in order to maintain a consumer-friendly schedule and level of capacity. There is no “one size fits all” solution but care must be taken so as to avoid anti-competitive cartel-like outcomes.

5. Access to **ground handling** services will be on commercial basis. Commercial access to ground handling, including self handling, should be supported.
6. **State Aid** to national airlines will be removed. The removal of state aid is a difficult and complex issue. For example, how do you precisely define state aid? How can state aid be distinguished from injection of fresh capital? The ASEAN Secretariat ATWG should perhaps consider both the experience of the European Union in dealing with state aid allegations against both Italy’s Alitalia and Greece’s Olympic Airways. In the former case, a negotiated settlement has been approved; in the latter, it is reported that Olympic Airways has received illegal state aid. There are important principles at stake, and the issue needs careful and thorough investigation. It is also noted that ICAO and the World Tourism Organization have recently published a study which sets out criteria for establishment of tourism development routes. This work should also be considered in the context of state aid.

Whilst it is not possible to say that there should be no subsidies, any subsidy should be transparent and should not place competitors at a disadvantage.

7. A **safety net and safeguards** mechanism to ensure sound competition. Sound competition is desirable; however, how could it be achieved? Few ASEAN member countries (probably only Singapore) have competition policy legislation. It has been suggested that an industry-specific ASEAN wide regulator should be established. That would be a brave and difficult step to take.
8. **Common rules governing airline operations, airline liability, airline customer protection, air safety and security , slot allocation**: Authorization of all relevant legislation should be fully supported, bringing about certainty, and assisting in lowering costs. This, however, is not an easy process – considerable work will be required to establish what relevant legislation in each country would be, and how it might be harmonized across ASEAN. A specific consultancy would be required, as well as the support of a legal sub-committee of the Air Transport Working Group,
9. A **common war risk insurance scheme**: A common war risk insurance scheme is desirable, and the necessary background work to achieve it could be tied in to the legally focused consultancy sought for the “safety net and safeguards” agenda.