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STATE INTERVENTION IN AIR TRANSPORT: EXPERIENCE FROM THE REPUBLIC OF INDONESIA

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Abstract

State intervention of the air transport industry is a widespread practice throughout the world where this kind of interference from the government to the air transport industry could be in the form of state aid or state subsidies. This paper attempts to explain the impact of state aid in the competition of air transport in The Republic of Indonesia resulting distortion in the competition of the aviation industry. This paper examines the state aid practice in The Republic of Indonesia and attempts to answer the debate whether this practice resulting in an unfair competition and violating level playing field in air transport in Indonesia or such method then creates an efficiency in air transport in Indonesia which makes it a good policy. However, this paper will not look into the analysis of the difference between terminologies on State aid and State subsidies.

Keywords: *state intervention, air transport, state aid, state subsidy*

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I. INTRODUCTION

Precisely air transport in the view of competition law is a contentious topic given the fact that there are no international rules of competition.¹ One of the hot issues in this respect is the State intervention to the air transport practice in the form of State aid.² Air transport in The Republic of Indonesia (from now on referred as “Indonesia”) plays a significant role in transporting the population of more than 237 million which spread across more than 10.000 islands to develop the economy of the country.³ The practice of State aid in air transport leaves some perceptions regarding the fair competition in effect where there is a presumption that state aid as such distorts the market.⁴ The danger is that the distortion of competition produced by state aids in favoring one air carrier over another means that any gains of liberalization will be

¹ Dario Klasic, *Flying on the Edge of Legalities – Safeguarding Fair Competition in European and International Aviation*, (Zhornik PFZ, ed 2-3), page 249.

² *Ibid*

³ Organization for Economic Co-operation and Development Report No.DAF/COMP/WD (2014) dated 28 May 2014 as presented in the 121st meeting of OECD Competition Committee on 19 June 2014, page 3.

⁴ Klasic, *Op.Cit.*, page252.

thwarted.⁵

This paper will examine the practice of State aid in Indonesia from the view of aviation competition law regime to determine whether it distorts the air transport market or unsurprisingly, it creates efficiency in the industry. This elaboration is necessary considering the objective of the competition law is to create fair competition and a level playing field throughout the industry. However, it is not the position of this paper to elucidate profoundly on the differences in terminologies between State aid and State subsidies. This paper will then contemplate on the dilemma in the State aid regime that has been come up to this end based on the practices in several States. Then this paper will provide several critical methods regarding State aid from the government to Indonesian airlines based on the current legislation in Indonesia. Finally, the analysis on the fair competition and level playing field regarding State aid in Indonesian air transport shall be the final argument of this paper to explain to the readers how the State aid practices in Indonesia and how does it affect the aviation market in general. This paper will also recourse to the need of State aid guideline in Indonesia in the future considering the projection of aviation market in South East Asia.

II. ON THE VIEWS OF STATE AID IN INDONESIA COMPETITION LAW REGIME

To begin with, it is worth to understand the concept of State aid about air transport in practice. However, discussing a State aid is a complicated issue.⁶ For general purpose, to give a general and introductory idea, it is possible to refer to the Oxford Online Dictionary, which defines subsidies as “a sum of money granted from public funds to help an industry or business to keep the price or commodity or service low”. Going forward, subsidization can cover an impressive range of measures. Direct government funds are not the only way to grant subsidies since they can also take the shape of tax concessions, loan guarantees or the provision of goods and services at no cost or below

⁵ Bernardine Adkins, *Air Transport and E.C. Competition Law*, (London: Sweet and Maxwell Limited, 1994), page141.

⁶ Mike Tretheway and Robert Andriulaitis, *What do We Mean by a Level Playing Field in International Aviation?*, International Transport Forum Discussion Paper 2015-2016, page 12.

market price.⁷ Again, as mentioned above, since there is a contentious debate on the effect on State aid practice in air transport that will create market distortion, it should be prudently determined whether the same method will generate the same impact in aviation market in Indonesia.

In light of fair competition, referring to the Chicago Convention,⁸ the Convention's Preamble stipulates "that international air transport services should be established by "equality of opportunity" and operated soundly and economically.⁹ Going further, one of the objectives of ICAO is to "ensure that the rights of contracting States are fully respected and that every contracting State has a "fair opportunity" to operate international airlines. Also, ICAO is bound to foster the development of international air transport to "avoid discrimination between contracting States" and to prevent economic waste caused by unreasonable competition."¹⁰ The matter of a level playing field has also emerged as a major issue in international aviation.¹¹ However, no one has precisely defined what constitutes a level playing field in aviation, or its converse, what constitutes a certain unlevelled playing field.

Law No. 5 of 1999 on the Prohibition of Monopolistic and Unfair Business Practice (from now on referred as "Competition Act") shall be the single instrument dealing with the competition regime in Indonesia. It is worth noting that under Competition Act there are no provisions explicitly aimed at the aviation or aviation related industries.¹² However, that does not mean that aviation industry is immune from the Competition Act where the Competition Act granted the authority to supervise competition to The Supervision Commission for Business Competition (*Komisi Pengawas Persaingan Usaha*).¹³ Price fixing by INACA (Indonesia National Air Carrier Association) was among the first cases that the Commission examined. In summary, the facts above resulting hot topics worth a discussion on the effect of state aid

⁷ Collin Law, *Subsidy and Fair Competition*, Vol 1 Issue 2, Aeronautics and Aerospace Open Access Journal, page 2.

⁸ Convention on Civil Aviation, signed at Chicago on 7 December, ratified by 192 members per November 2017. ("Chicago Convention")

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ Mike Tretheway, *Op. Cit.* page 1.

¹² Eri Hertawan and Yogi Sudrajat, *The Aviation Law Review Chapter 16: Indonesia*, edited by Sean Gates, (Law Business Research Ltd, 2014) page 188.

¹³ *Ibid.*

in Indonesia that may distort the competition and violate a level playing field. Since those state aid practices in Indonesia resulting many opinions that such air may cause distortion in air transport market, the following chapter shall attempt to elucidate the practices on State aid policies in Indonesia to the airlines for the purpose of restructuring, flying to the remote regions, and some forms of capital injection by the government and other facilities provided by the government.

II. STATE AID PRACTICES IN INDONESIA

It is the purpose of this paper to attempt to look further into the traditions of the State aid given by the government of Indonesia to the air transport sector. These practices have been done or currently undergoing in decades which then will subject to further analysis whether these practices could violate fair competition and the level playing field in competition law regime in Indonesia, while there is a debate upon the applicability of the Competition Law in air transport industry in Indonesia.¹⁴

A. AID FOR RESTRUCTURING

The financial and economic crises in the last decade of the twentieth century, and at the end of the first decade of the twenty-first century, forced many airlines to restructure their operations.¹⁵ Successful restructuring required public money, particularly on the part of those airlines that were wholly or partially owned by their governments.¹⁶ In Indonesia, Merpati Nusantara Airlines (from now on shall refer as “Merpati”) shall be the obvious example of how government involves in air transport sector to rescue this airline. Merpati is a state-owned company which established in the first place to become a specialist in pioneer flights.¹⁷ However, the problem occurred when Merpati did not compete on a level playing field within the same domestic market.¹⁸

¹⁴ Fachri Mahmud, *ASEAN ‘Open Sky’ dan Tantangan Bagi Indonesia*, (Mahmud Yunuz Wadzuriyah, 2012) page 223.

¹⁵ Pablo Mendes de Leon, *Introduction to Air Law: Tenth Edition*, (The Netherlands: Kluwer Law International, 2017), page 116.

¹⁶ *Ibid.*, page 117.

¹⁷ Chappy Hakim, *Believe it or Not: Dunia Penerbangan Indonesia – Terbang Aman dan Nyaman Walau Banyak Masalah*, (Jakarta: Penerbit Buku Kompas, 2014), page 122-124.

¹⁸ *Ibid.*

Merpati had received numerous capital injections from the government since 2001 following its financial *woes*.¹⁹ In 2008 the airline received an injection with a total amount of US\$ 30 million for operational cost.²⁰ Then, Merpati also received another injection in the total amount of US\$ 58.34 million in 2011 without any settlement arrangement just to make Merpati keep operating.²¹ Currently, Merpati cannot be regarded as bankrupt meanwhile they just ceased their operations and waiting for further capital injection either by the government or by the investor who willing to buy Merpati to its renaissance.²²

B. AID FOR PIONEER ROUTES IN REMOTE REGIONS

The existence of pioneer routes in Indonesia has increased from time to time, as a commitment from the government to develop the economy in remote islands and areas as mandated by the Constitution of the Republic of Indonesia.²³ Indonesian Aviation Law defines “pioneer routes” (or *route perintis*) as:

*“...route(s) which linked the Indonesian isolated and remote regions and islands, or any other regions and islands that have not been reached by any mode of transportation and such route commercially has no profit.”*²⁴

In the beginning, Merpati was the emperor in this routes having received the state aid from the government to fly on the remote regions.²⁵ However, after recent development in Indonesia Aviation business, ASI Pudjiastuti Aviation (known as “Susi Air”), which was founded in 2004, has emerged to become the dominant player of pioneer routes.²⁶ About the pioneer routes, the government of Indonesia also grants a so-called

19 Ridha Aditya Nugraha, *State Aid for Pioneer Routes under Public Service Obligation in Indonesia: Against the Tide within ASEAN Open Skies?*, Masters of Law Thesis, Leiden University Advanced LLM in Air and Space Law, page 66.

20 Kompas, “Akhirnya Merpati Diputuskan Dijual,” <https://ekonomi.kompas.com/read/2013/07/11/1848546/Akhirnya.Merpati.Diputuskan.Dijual> as accessed 13 March 2018.

21 *Ibid.*

22 Ridha, *Op. Cit.*, page 68.

23 Article 33 (2) of The Constitution of The Republic of Indonesia said that “Sectors of production which are important for the country and affect the life of the people shall be under the powers of the State.” Translation provided by International Labour Organisation (ILO).

24 Article 1(18) of the Indonesian Aviation Law of 2009.

25 Ridha, *Op. Cit.*, page 76

26 *Ibid.*

subsidy to the air cargo serving in remote areas.²⁷ In the performance of this pioneer routes, regarding selecting the airline to perform such air services, the Ministry of Transportation of the Republic of Indonesia will choose the airlines based on a tender basis²⁸ where any airlines which are propitious to operates the pioneer routes will be granted compensation in forms of;

- i) Allocating other routes other than the designated pioneer route;
- ii) Subsidy on the operational costs of air service; and/or
- iii) Subsidy on the fuel in such service.

There is a debate whether this kind of operation shall be considered as operation under Public Service Obligation or State aid. However, one of the aviation experts from Indonesia, Prof. Martono stated that this operation of pioneer routes is considered as State aid.²⁹

C. CAPITAL INVOLVEMENT AND FACILITATION PROVIDED BY THE GOVERNMENT

Capital injection by the government in air transport shall be an exciting issue to elaborate. Government giving subsidy to airlines is a common practice where, in fact, most of the flag carriers operating today are commonly established with the help and support from the government.³⁰ In this matter, the regulation which applicable is Indonesia State-Owned Enterprise Law of 2003.³¹ One of the purposes of the Indonesian State-Owned Enterprise Law is to provide a public service for Indonesian citizen³² where the State shall guarantee the fulfilment of this obligation through the establishment of a State-owned enterprise. As a result, a recent issue was the grant of a state capital injection where this grant is only given to the state-owned companies,

²⁷ Article 17 of the Ministry of Transportation Decree No. 79 of 2017 on Criteria and Performance of Pioneer Air Transport and Air Cargo Subsidisation said that “in order to support the deficit of the price of the goods in the underdeveloped, isolated, and border regions, Government shall provide subsidy for Air Cargo.

²⁸ Article 25 of the Ministry of Transportation Decree No. 79 of 2017 on Criteria and Performance of Pioneer Air Transport and Air Cargo Subsidisation.

²⁹ H.K. Martono, Agus Pramono, and Eka Budi Tjahyono, *Pembajakan Angkutan dan Keselamatan Penerbangan*, (Jakarta: Gramata Publishing, 2011), page 111.

³⁰ Collin Law, *Loc. Cit*

³¹ *Ibid.*

³² Article 2(1) of the Indonesian State-Owned Enterprise Law states that “The objectives and purposes of establishment of a State-Owned Enterprise shall be to make contributions to national economic development in general and state revenues in particular.

where the money is derived from the state budget.³³

In Indonesia, the flag-carrier, Garuda Indonesia and again, Merpati become two airlines which established as state-owned airlines meaning that they received sums from the State resource, in this respect the State Budget, to offer a public service to Indonesian citizens. Other forms of State aid practices in Indonesia is facilitation from the government about air transport to boost the industry to be able to compete with another air carrier within Asia.³⁴ In 2015, the government of Indonesia released an economic package which one of its points is exempting the airlines from the customs charge for the spare parts for aircraft.³⁵ In response, the Chief Executive Officer of Lion Air said that such policy would create the MRO business in Indonesia to become more competitive and thus reducing the cost for airlines.³⁶ Therefore, these practices or procedures enacted by the governments of Indonesia obviously created to strengthen the aviation industry in Indonesia by assisting in generating more competition in this market.³⁷

D. COMMENTS ON CAPITAL EQUITY

This paper has a comment on the State-owned airlines being considered receiving State aids. Capital increases by way of shares or debentures are not uncommon in the air transport sector. State participation in the capital of a company is one type of government intervention that will not necessarily be deemed to be state aid.³⁸ The state aid rules will apply to such participation only where a State invests capital in a company in the circumstances other than where a private sector would have similarly acted.³⁹ As in Indonesia, Garuda Indonesia and Merpati enjoy the privilege of being State-owned enterprises where they receive some funds annually from the government it does not mean

³³ <https://www.cnnindonesia.com/ekonomi/20150120205918-92-26080/dpr-kritik-penyertaan-modal-negara-kepada-bumn> as accessed on 14 March 2018.

³⁴ <http://www.kemenperin.go.id/artikel/8348/Pemerintah-Didesak-Bebaskan-Bea-Impor-Komponen-Pesawat> as accessed on 14 March 2018

³⁵ <https://finance.detik.com/berita-ekonomi-bisnis/d-3101502/paket-jilid-viii-jokowi-bea-masuk-spare-part-pesawat-0>. Accessed on 14 March 2018.

³⁶ <https://www.merdeka.com/uang/lion-air-sambut-positif-tarif-bea-masuk-komponen-pesawat-0-persen.html>. Accessed on 14 March 2018.

³⁷ *Ibid.*

³⁸ Adkins, *Op.Cit.*, page 148-149.

³⁹ *Ibid.*

that such capital equity considered as State aid.⁴⁰ Moreover, doing some investigations in the airline business is allowed in Indonesia. Based on the Indonesia Investment Law of 2007, the airline business may have a foreign investor at the maximum of 49% percentage which, in author's opinion, it could be deemed as a compatible provision to accommodate the principle of ownership and effective control in the aviation industry. The thing that should be noted from the Investment Law is the investment should be a direct investment which is through direct shares ownership and not through the capital market mechanism.⁴¹

E. CONCLUDING REMARKS

From the aforementioned practices on State aid in Indonesia air transport, in summary, the State aid practice that provided by the government of Indonesia to the airlines merely for the purpose to salvage the airline which designated for public interest purposes as mandated by Indonesian legislation and to fulfill the need of transportation in the remote area as part of public service from the government.⁴² Moreover, the capital injection given by the State to the State-owned airlines cannot be considered as State aid unless, again, State invests capital in a company in the circumstances other than where a private sector would have similarly acted. The next chapter of this paper shall focus on analyzing the current practices of State aid in Indonesia in effecting the aviation market by determining the aid given by the State distorts the level playing and fair competition field in such industry. There will also be an analysis of whether there is a need to enact the guideline for State aid in the aviation industry.

III. ANALYSIS ON THE POSSIBLE DISTORTION RESULTED FROM STATE AID

Aviation industry acknowledges many different players in the industry which one of them is airlines. These players are not in the same capacity as some have more experience and assets, and some have the

⁴⁰ Ridha, *Op. Cit.*, page 81.

⁴¹ Elucidation of Article 2 of Indonesian Investment Law No. 25 of 2007 states that "Investments in all sectors in the territory of the state of the Republic of Indonesia" means direct investments, not including indirect or portfolio investments."

⁴² Ridha, *Op.Cit.*, page 77.

governments supporting their operation where this phenomenon occurs since States have great influence in the aviation sector. In this section, this paper will further put analysis on the possibilities of the market distortion. In doing so, a comprehensive approach on fair competition regime and a level playing field will be the spotlight which then will be finalized by an argument on should Indonesia try to create a guideline in State Aid for the aviation industry.

A. TOWARDS FAIR COMPETITION

As long as the competition rules ensure fair competition in the marketplace, there is, therefore, nothing wrong with state aid.⁴³ Regarding fair competition, State aid only becomes a problem in markets where free competition exists, i.e., ‘open markets’, with free entry, where competition law replaces the economic regulation, and where a more or less level playing field exists for competing for air carriers.⁴⁴ It is the stand of this paper that in Indonesia, the concern over the fair competition is on the State aid in restructuring airlines. Merpati case is a distinct sample of unfair business practice within Indonesian competition regime.

The nonstop aid granted by the government before it operations were ceased caused other competitors who would like to enter into pioneer routes is prevented since Merpati kept alive from such aid.⁴⁵ Furthermore, from the same case, it is obvious that the government tried hard to protect the State-owned enterprise without bearing the Competition Law regime in the aviation industry.⁴⁶ Again, since there is no legitimate legislation in Indonesia Competition Law on State aid, to evaluate the State aid in pioneer routes by competition law regime, the market assessment should be considered.⁴⁷ Pioneer routes is nonetheless not an open market where there is no free market, and thus any airlines who would like to operate in pioneer routes shall place a tender to the government.⁴⁸ In other words, in other words what an

⁴³ Henri Wassenbergh, *The Regulation of State-Aid in International Air Transport*, Air and Space Law Journal No. 3 Vol XXII, page 161.

⁴⁴ *Ibid.*

⁴⁵ Ridha, *Op. Cit.* page 65-68.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

Open Skies fair competition clause tries to achieve and maintain is a level playing field,⁴⁹ which is the same as equality of opportunity rather than equality of outcome. It is the responsibility of the governments of the contracting parties to make sure a level playing field is established and upheld. In other words, it is up to States to interpret ‘level playing field’ and decide which type of behavior is anti-competitive and which is not. This leads to a contradiction.

B. REACHING LEVEL PLAYING FIELD

Concerns about level playing field have emerged in aviation in recent years, and only a little has defined what constitutes a level playing field, or in other words, what makes an unlevel playing field.⁵⁰ It does not mean that government should compensate based on airline size. The government should not provide artificial support in the form of subsidy to smaller carriers to make it more equally competitive with another competitor.⁵¹ Learning from the practice of European Union, there are two behaviors that is seen as distortive to the level playing field which are the air carrier blacklisting and state aid. The former, the blacklisting, is conducted by the European Union according to procedures laid down in Regulation 2111/2005. As stated in this Regulation, air carriers could face an operating ban if they do not meet the EU safety requirements, which are stricter than ICAO’s requirements. There has been criticism regarding the political bias, non-frequent updates, and lack of transparency of this listing.⁵² Although the aim of this listing is safety, there are some States that regard it as having anti-competitive effects.

Going forward to the latter, state aid is seen as distortive to the level playing field for some States but might be permissible for other States is state aid. The European Union’s (EU) Regulation 868/2004 is designed to protect EU air carriers against injury caused by subsidization and unfair pricing practices from non-EU countries. This Regulation does not prohibit air carriers from being State-owned, for this does not necessarily create negative impacts on the level playing field.⁵³ In the

⁴⁹ Wassenbergh, *Op. Cit.*, page 199.

⁵⁰ Mike Tretheway, *Op. Cit.* page 17.

⁵¹ *Ibid.* page 8.

⁵² R. Wall, ‘Blacklist Battle,’ in (ed. J. Anselmo) *Aviation Week & Space Technology Volume 171* (2009), page 33.

⁵³ *Idem*, page 12.

case where allowance is needed for air service for a public purpose, but the subsidy is available to any carrier, and it is granted by an open competition through beauty contest, it could be argued that this does not violate the level playing field.⁵⁴ However, in a situation where a carrier does receive a subsidy from government (other than for socially required services), and that in case if such subsidy is not available to others, or is not granted on the basis of a tender or, this could trigger concerns about the level playing field and would require further investigation from competition authority.

It is the practice that currently applicable in the pioneer routes where any airlines which would like to operate this route shall propose itself to the Ministry of Transportation.⁵⁵ Based on the above explanations, apparently, there are two main concerns here. First, is whether individual carriers are provided by subsidy or not, and the second is whether any such support distorts the aviation market. In the case of Indonesia, again, providing the aid for Merpati State aid to keep the airline stays in the market creates unlevel playing field with the other competitor because the government only giving such aid to its State-owned enterprise, not to the other airlines.⁵⁶ Had Merpati not been granted such significant amount of money from the Indonesian government, it should have been bankrupt since long time ago.⁵⁷

C. NEED FOR LEGISLATION IN THE FUTURE?

Neither in Indonesian Aviation Law nor the Competition Law has a provision regarding state aid for airlines. The latter could be of assistance by providing definitions related to market distortion and unfair competition to outline State aid. Considering the rapid growth of airline business in Indonesia. This paper views that the government should start to think in creating legislation for State aid in Indonesia aviation industry. This legislation could be designed under the supervision of the Commission of Business Practice Supervisor so, therefore, it will be in line with the Indonesian Competition Law regime. This legislation on State aid primarily could determine the concept of Public Service

⁵⁴ *Ibid.*

⁵⁵ Article 26

⁵⁶ Ridha, *Op. Cit.* page 68-69.

⁵⁷ *Ibid.*

Obligation or the compensation policy for airlines serving the pioneer routes.⁵⁸ Furthermore, this legislation also should lighten the aid for restructuring the airlines.⁵⁹ The importance of this legislation should be under KPPU is because it will ease the task of the commission to examine the State aid rules by effect or object as has been mandated by the Indonesia Competition Law.⁶⁰

IV. CONCLUSION

To provide any State aid to airlines is the right of any States. Such aid is only could be questioned if it is used by the recipients in such way that it, in fact, distorts competition in a free market where competitors compete on a level playing field. Operational subsidization, through public funds, which used to cover operational losses is also acceptable. Of course, such policy is fair as long as the losses are not the result of anti-competitive behavior and the aid is not used for anti-competitive conduct in the market, for instance, to quote below-cost prices in the market. However, for the interest of pure competition, the State should not unnaturally keep any airlines alive by subsidies or by granting aid for restructuring if such airlines should have been exited the market. The concern about level playing field also becomes a contentious issue in recent years. The areas of concern are if there are any carrier-specific subsidies.

However, such concern is not including subsidy for specific air service obligation especially if eligibility to operate such air service is competitive and non-discriminatory. This paper has reflected the practices of State aid in Indonesian air transport where it is used for the interest of aviation industry in Indonesia and the benefit of the people of Indonesia. This paper concludes that legitimate legislation, being the new rules on the State aid for Indonesian air transport is necessary preliminary step for Indonesia towards the future. The norms, especially on the restructuring matter, are needed so that the government of Indonesia would not suffer a loss to its State Budget to artificially help any airlines keep alive while it should supposedly exit the market based on pure competition rules.

⁵⁸ Ridha, *Op. Cit.* page 78-80.

⁵⁹ *Ibid.*

⁶⁰ *Ibid.*

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