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ASEAN SINGLE AVIATION MARKET AND INDONESIA - CAN IT KEEP UP WITH THE GIANTS?

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Abstract

Indonesia's demand for air transport is higher in proportion to its GDP per capita. Its economy can be expected to grow 6% to 10% annually. A single aviation market could add another 6% to 10% growth in sheer demand. Yet its airports are badly in need of expansion, its infrastructure is bursting at its seams, and above all, its airlines are strongly resisting liberalization of air transport in the region for fear of being wiped out by stronger contenders in the region. Against this backdrop, it is incontrovertible that Indonesia's civil aviation is intrinsically linked to regional and global considerations. A single aviation market in the ASEAN region will bring both benefits to Indonesia and challengers to its air transport sector. This article discusses the economic and regulatory challenges that Indonesia faces with the coming into effect of the ASEAN Single Aviation market in 2015.

Keywords: ASEAN, Single Aviation Market, Regional Law.

Abstract

Permintaan transportasi udara di Indonesia lebih tinggi sebanding dengan PDB per kapita. Ekonominya dapat diperkirakan akan tumbuh 6 % sampai 10 % per tahun. Sebuah pasar penerbangan tunggal bisa menambah 6 % sampai 10 % pertumbuhan permintaan. Namun, bandara-bandara yang sangat membutuhkan ekspansi, infrastruktur yang meledak di perusahaan, dan di atas semua, maskapai yang secara kuat menolak liberalisasi angkutan udara di wilayah ini karena takut dihapuskan oleh pesaing kuat di wilayah tersebut. Dengan latar belakang ini, tak terbantahkan bahwa penerbangan sipil di Indonesia secara hakiki berhubungan dengan pertimbangan regional dan global. Sebuah pasar penerbangan tunggal di kawasan ASEAN akan membawa manfaat baik bagi Indonesia dan penantang untuk sektor transportasi udara. Artikel ini membahas tantangan ekonomi dan peraturan yang dihadapi Indonesia dengan berlakunya Pasar Penerbangan Tunggal ASEAN pada tahun 2015.

Kata Kunci: ASEAN, Single Aviation Market, Hukum Regional.

I. Introduction

Air transport generated 1.8 million direct jobs and supported 24.2 million jobs in the Asia Pacific¹ region in 2012. The Industry generated \$ 516 billion during the same

¹ Although the Asia Pacific region has been defined as a business region consisting of the whole of Asia as well as the countries of the Pacific Rim, there does not seem to be a clear definitive identification of the component States of the region. However, the 10 ASEAN nations are included in economic considerations of the region.

period² and is therefore the region is a major player in global air transport.

The Association of South East Asian Nations (ASEAN) is comprised of ten countries³ which will come under an Open Skies Policy (OSP) under the ASEAN Single Aviation Market (ASAM) from 2015⁴. The ASEAN Economic Community (AEC)⁵, which has as one of its aims the creation of a region fully integrated into the global economy, and which in turn is reflective of an economic integration plan in the region, considers air transport as a critical and significant thread in the transport fabric of the region. The implementation of ASAM would hinge heavily upon the disparity of the political and economic nature of ASEAN member States. One of the key factors in this equation is the differing priorities accorded by each State to air transport.

Indonesia, which is the largest member State of ASEAN, is an archipelagic country embracing nearly 17,000 islands accommodating 231.4 million people which represents 39% of the total population of the ASEAN member States. These islands span over 113,700 square miles. This spread of population inevitably brings to bear a compelling need to lay emphasis on and prioritize connectivity if the country were to prosper and grow its GDP⁶ through the enhancement of resources and industries. Air transport is the logical driver of connectivity as other modes of transport such as road, rail and sea are cumbersome due both to the vast distances involved in Indonesia and the poor infrastructure that is incapable of supporting them.

Indonesia had 29 international airports in 2012, the largest in the ASEAN region⁷. The country has an open skies agreement with the United States (signed in 2004). In exchange for full fifth freedom rights into Indonesia for any US carrier from any point in the United States, Garuda Indonesia (as the only Indonesian carrier) operates to the United States. Garuda uses liberal code sharing agreements with other carriers to operate US-Indonesia and EU-Indonesia routes. 25 million international passengers

² Aviation Benefits Beyond Borders, Air transport Action Group (ATAG), April 2014, at 36.

³ The Association of Southeast Asian Nations (ASEAN) was formed in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand to promote political and economic cooperation and regional stability. Brunei, Cambodia, Laos, Myanmar and Vietnam later joined the Association. ASEAN covers a land area of 4.46 million km², which is 3% of the total land area of Earth, and has a population of approximately 600 million people, which is 8.8% of the world's population. The sea area of ASEAN is about three times larger than its land counterpart. In 2012, its combined nominal GDP had grown to more than US\$2.3 trillion.

⁴ Recognising the growing importance of trade in services, ASEAN countries officially launched their joint effort to work towards free flow of trade in services within the region through the signing of ASEAN Framework Agreement on Services (AFAS) on 15 December 1995 by ASEAN Economic Ministers (AEM) during the 5th ASEAN Summit in Bangkok, Thailand.

⁵ The ASEAN Economic Community (AEC) is the goal of regional economic integration by 2015. AEC envisions the following key characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. According to the AEC Blueprint which has been signed by all ASEAN nations, the AEC is the realisation of the end goal of economic integration as espoused in the Vision 2020, which is based on a convergence of interests of ASEAN Member Countries to deepen and broaden economic integration through existing and new initiatives with clear timelines. In establishing the AEC, ASEAN is required to act in accordance to the principles of an open, outward-looking, inclusive, and market-driven economy consistent with multilateral rules as well as adherence to rules-based systems for effective compliance and implementation of economic commitments.

⁶ The Organization for Economic Cooperation and Development (OECD) defines Gross National Product (GNP) as an aggregate measure of production equal to the sum of the gross values added of all resident institutional units engaged in production (plus any taxes, and minus any subsidies, on products not included in the value of their outputs).

⁷ The second largest number of international airports is 10 in the Philippines. Singapore and Brunei have one international airport each and no domestic airport.

- 48% of whom travel to and from ASEAN member States - reflect an average of 20% traffic increase annually (both domestic and international traffic)⁸, which is consistent with the rate of national economic growth.

ASAM is one of the key priorities in the overall AEC scheme and AEC will come into effect with the ASEAN Open Skies Agreement (AOSA) in 2015. ASAM is based on two supporting agreements - The Multilateral Agreement on Air Services (MAAS) which was signed in 2005 and the Multilateral Agreement on the Full Liberalization of Passenger Services (MAFLPAS) which was signed in 2010. Both these agreements provide for the relaxation of market access (which is provided for in the Protocols of both agreements) with regard to third, fourth and fifth freedom traffic rights, to the exclusion of seventh freedom rights⁹ and cabotage¹⁰. There is also a great degree of relaxation of ownership and control of airlines, allowing operators flexibility to exercise their principle place of business as the main basis of their operations from and to ASEAN member States¹¹. Furthermore, there is flexibility allowing a carrier to override the traditional 49% requirement of foreign investment in an airline subject to the condition that the grantor State which receives the application to operate air services into its territory agrees.

However, ASAM is fettered by the fact that, for it to come into effect, at least three ASEAN member States have to deposit their instruments of ratification or acceptance, which dispels a common misconception that AOSA transforms the region into a fully liberalized air transport sector. Indonesia is expected to ratify the two MAFLPAS Protocols in 2015. The liberalization policy of Indonesia - particularly with regard to coming under AOSA - is resisted by the carriers of Indonesia who would prefer to stay with the *status quo ante* of the bilateral air services agreement that ensures them of some protection and control against the giants of the ASEAN region, who they fear will not respect the market needs of the region¹². The Indonesian carriers' argument is that they are sufficient to provide the capacity needed and that they are capable of catering to Indonesian traffic demands both internationally and domestically. Other member States, particularly Singapore and Malaysia are less rigid, and both Singapore

⁸ Five large airlines - Garuda, Lion air, AirAsia, Sriwijaya and Batavia operated 90% of the international air routes in Indonesia in 2012. Batavia went bankrupt in 2013.

⁹ A seventh freedom right grants the right to a country's aircraft to fly between two foreign countries while not offering flights to one's own country. It is the right or privilege granted by one country to another country, of transporting traffic between the territory of the granting country and any third country with no requirement to include on such operation any point in the territory of the recipient country. The service need not connect to or be an extension of any service to/from the home country of the carrier. For example, air traffic from England going to Canada on a U.S. airline flight that does not stop in the United States.

¹⁰ Cabotage is the exclusive right of a country to operate the air traffic within its territory. This right is usually not given to foreign carriers. Called the Eighth Freedom, this right is not expressly forbidden but considered a discretionary right in the Convention on International Civil Aviation (Chicago Convention) which provides that each contracting State shall have the right to refuse permission to the aircraft of other contracting States to take on in its territory passengers, mail and cargo carried for remuneration or hire and destined for another point within its territory. Each contracting State undertakes not to enter into any arrangements which specifically grant any such privilege on an exclusive basis to any other State or an airline of any other State, and not to obtain any such exclusive privilege from any other State. See Convention on International Civil Aviation, signed at Chicago on 7 December 1944, ICAO Doc 7300/9, 9th Edition:2006, Article 7.

¹¹ This concession admits of an airline's majority shares to be outside the State which designates the carrier, provided the seat of incorporation lies in the designating State.

¹² Most bilateral air services agreements between Indonesia and ASEAN member countries have stringent capacity and frequency limitations enforced by confidential memoranda of understanding. The most constrained routes are Jakarta-Singapore and Jakarta-Kuala Lumpur.

and Malaysia have already an open skies agreement between them. One of the reasons why both Indonesian and Philippines' carriers oppose open skies is that they have substantial domestic markets which they hub in terms of connecting them to international transport which they think may be captured by the *carte blanche* entry into their markets by carriers such as Singapore Airlines, Thai Airways International and Malaysian Airlines System.

On the airports side, Indonesian airports could be affected by AOSA, as 16 of the 26 largest airports in the country are already running at over capacity. Sukarno-Hatta Airport in Jakarta has its existing terminals overflowing and its two runways are overcrowded. Although in 2013 a major upgrade of the airport was undertaken, it is expected that the exponential growth of capacity demand will make this upgrade ineffective by the time it is completed. Even if the overall upgrade of its airports are underway, Indonesia could have the common problem of capacity demand overriding any measures taken to meet it.

II. Integration Into The Global Economy

A. The Global Economy

AEC's aim to integrate ASAM into the global economy (which has already been alluded to) is a key consideration in addressing the effects of AOSA on Indonesia. AEC aims at four key results: a single market and production base; a highly competitive economic region; a region of equitable economic development; and a region fully integrated into the world economy. These aims have already been recognized by the global aviation community. For example, The ASEAN Air Transport Integration Project (AATIP) of the European Aviation Safety Agency (EASA) aims at contributing towards sustainable ASEAN economic growth and the integration of the ASEAN Economic Community (AEC), through the development of the civil air transport sector.

In order to support this overall objective, AATIP will facilitate the development of the institutional frameworks to strengthen institutional capacities within ASEAN with a view to supporting the achievement of a safe, secure and sustainable ASEAN Single Aviation Market based on high regulatory standards.

If AEC is to integrate into the world economy, the members of ASEAN would have to be aware of economic trends in global air transport and the challenges of market access worldwide. Therefore, a key consideration for Indonesia would be to align its aviation policy and approach towards global trends. The first step would be to forsake protectionism and embrace competition and the way forward towards connectivity. In this regard, a question for Indonesia would be whether ASAM would boost its tourism industry. UNWTO recorded in 2007 that the number of international tourist arrivals has risen from 25 million in 1950 to 840 million in 2006. The revenues generated by these arrivals – not including airline ticket sales and revenues from domestic tourism – have risen at an average rate of 11.2 per cent a year (adjusted for inflation) over the same span of time, which is nearly twice as fast as arrivals and a growth rate that far outstrips that of the world economy as a whole. International tourism receipts reached 735 billion dollars in 2006, almost 900 billion including air tickets, making tourism not only a socio-economic driver but one of the largest categories of international trade. Tourism represents one quarter of all exports of services – 40 per cent with air transport revenues included. It is also noteworthy that the growth trend will continue, as according to a news release of 18 September 2007 issued by

the International Civil Aviation Organization (ICAO), total world airline scheduled passenger traffic in terms of passenger-kilometers is expected to grow at an average annual rate of 4.6 per cent up to the year 2025, half a percentage point lower than the growth rate achieved over the period 1985-2005, according to forecasts prepared by ICAO. Total freight traffic growth over the same period is forecast to be stronger, at 6.6 per cent per annum in terms of freight tonne-kilometers.

There can be particular benefits from tourism for the poorest economies, where international arrivals are growing at twice the rate in the industrialized States. Although they are still at a low level, the tourism receipts of the Least Developed Countries increased fivefold between 1990 and 2005, from 1 billion to 5 billion dollars. Tourism has become one of the largest sources of foreign exchange revenues for developing countries generally and for the 49 LDCs specifically, reducing their foreign debt and diversifying their economies. Tourism is often the principal service sector activity and it is a notably effective catalyst for gender equality, employment of young people, rural regeneration, cultural preservation and nature conservation.

Therefore WTO, which is the specialized agency of the United Nations with a central and decisive role in promoting the development of responsible, sustainable and universally accessible tourism, concludes that, for all these reasons, tourism can play a major role in improving the standard of living of disadvantaged populations and helping them lift themselves above the poverty threshold. Tourism can be a primary tool for achievement of the Millennium Development Goals of the United Nations, as long as a balance with climate change effects is maintained.

There is no doubt that tourism and air transport are symbiotic. Travel and tourism, the largest combination of industries and the largest creator of wealth, is estimated to generate \$ 3.5 trillion a year in activity and potentially provides employment to 130 million people worldwide. This accounts for 10 per cent of the world's GDP, 10.3 per cent of the world's wages, 9.8 per cent of the profits and 11.7 per cent of indirect and direct taxes. WTO has recorded that about 40 per cent of the 840 million international tourist arrivals in 2006 were by air. In terms of long haul destinations, this figure could be even higher. Furthermore, the vast majority of the 931 million international passengers in 2006 were tourists.

In the context of ASAM, would ASEAN airlines consider alliances? Would Indonesian airlines benefit by entering into such discussions with their ASEAN colleagues? This question could be answered with a look at the global economy and the situation of the airlines. Tony Tyler, Director General of IATA, the association of world airlines, had this to say at the Annual General Meeting of IATA held in Beijing in June 2012, As reported in *Air Transport News*:

the major benefits of aviation such as connectivity and economic welfares are evident in tremendous contributions of aviation to the global economy such as the provision of 57 million jobs worldwide. However, the state of the industry has been characterised as fragile, with 631 billion dollars revenue but only 3 billion dollar profit for 2012. with high oil prices, political risks around the world and the crisis in the Eurozone a large number of airlines is struggling to keep revenues ahead of costs. Governments and airlines should work as strong partners in order for modern economies to grow prosper and create jobs through being exposed to global opportunities.

Ironically, one could place these facts against the backdrop of pronouncements of high level policy makers who are increasingly reaching the conclusion that aviation

is making a substantial contribution to the global economy. *Oxford Economics*, an economic forecasting agency, in a recent report recognizes the wide range of benefits that air transport brings to economies and societies globally.

This report, issued in June 2009¹³, also suggests that the world's future prosperity may depend on a growing and thriving aviation industry, which currently supports nearly eight per cent of the world's economy, and questions the environmental benefits and social impacts of limiting that growth. One wonders, then, as to why an indispensable economic tool such as the air transport industry which contributes so substantially to the global economy¹⁴, is shackled by restrictions which other similar businesses are not subject to.

Strategic alliances of the airline industry is but a natural corollary to the exponential growth of international air transport as an industry. In an open skies environment under ASAM, alliances between disparately sized carriers could be a distinct possibility. The concept itself is based on the theory that with rapid demand for air transport, requiring a doubling of the 16,000 world aircraft fleet by the year 2015, these would be a compelling need for new connections between points and more frequencies to serve these connections. There is no stopping this trend, which has already swept the aviation industry. There is, however, one point of caution. The fundamental postulate of air transport has been, and remains to be, safety of passengers. The proliferation of aircraft in the skies may challenge airline safety, if parallel measures are not set in motion to ensure the safe passage of the thousands of aircraft in the sky.

How does one approach market access in the coming decades. At the most fundamental level, the advantages of free trade as would apply to air transport would be that it would encourage States to trade freely with their trading partners which would in turn help in the growth of the global economy; it would give the consumer a better choice of products and competition generated by free trade would bring down the price of the product. Arguments against free trade in air transport would be that globalization and liberalization will take jobs away from a State; the limit of imports would keep money in the State; free trade could be a threat to national security and a State could develop dependence on the expertise of other more advanced States. Free trade increases national wealth and promotes foreign investment, both of which are absent in the present structure of market access in many States.

The main consideration, leading up to efforts by the international aviation community to achieve a deregulated global airline industry, is involved with the question as to whether free market principles can be applied globally to air transport. What needs to be considered is whether we are ready to accept the throwbacks as consequences

¹³ Oxford Economics, Aviation, The Real World Wide Web, June 2009, http://www.oxfordeconomics.com/free/pdfs/ox_econ_aviation_report/main.html

¹⁴ ICAO has estimated that the direct contribution of civil aviation, in terms of the consolidated output of air carriers, other commercial operators and their affiliates, was 370 billion US dollars. Direct employment on site at airports and by air navigation services providers generated 1.9 million jobs while production by aerospace and other manufacturing industries employed another 1.8 million people. Overall, the aviation industry directly employed no less than 6 million persons in 1998. These direct economic activities have multiplier effects upon industries providing either aviation-specific and other inputs or consumer products. In simple terms, every U.S. \$ 100 of output produced and every 100 jobs created by air transport trigger additional demand of U.S. \$ 325 and in turn 610 jobs in other industries. The total economic contribution of air transport, consisting of the direct economic activities and the multiplier effects, is estimated at U.S. \$ 1 360 billion output and 27.7 million jobs worldwide. See The Economic Contribution of Civil Aviation, ICAO Circular 219: 2004 at 1. Also The Economic Benefits of Air Transport, 2000 Edition, ATAG:IATA, at 7. Also, ICAO Circular 219,Id., at 4.

of free market competition in air transport, particularly in losing national prestige projected by flag carriers. One of the corollaries to industry deregulation is the introduction of free market competition when companies switch from operative performance to competitive performance. Competition therefore emphasizes the need to focus on a company's performance in relation to its competitors. This principle can be readily apply to various industries that have already been deregulated, such as the motor vehicle industry, chemical industry and information technology industry. The operative question is "are these good analogies for application to the air transport industry?" Whatever be the answer to this question, if the deregulated domestic air transport industry of the United States were to be considered an analogy, one could say that a deregulated system in the United States, introduced in 1978, has led to a more efficient airline system in the country. Whatever be the case, access to facilities in a competitive market is essential toward attaining fluidity of market forces. In the air transport industry, this can be translated to mean that if free markets do not exist in the supply of complementary facilities, there will be no positive impact of liberalization. The complementary services in the supply of air transport are airport access, computer reservation systems and airport and air regulation services.

The International Chamber of Commerce (ICC), in a policy statement has expressed the view that the efficiency of air transport would be enhanced by creating more open markets and more flexibility with regard to foreign ownership. Given air transport's capability to facilitate economic activity¹⁵, its liberalization would enable the sectors that make use of it to become non efficient. ICC was in favor of a freer exchange of air services throughout the world and is convinced that it is time to move beyond the existing bilateral system, toward a genuine multilateral liberalization of air transport. Of course, liberalization would give way to competition, which in turn would impel airlines to pool their resources in order that they maximize on such assets as code sharing and airport slots. However, alliances do not necessarily mean lack of competition between partners. Airlines within alliances have to do their utmost to gain market access and keep their businesses alive. In order to do this both private enterprises and the States in which these enterprises are entrenched have to be equally competitive.

Any agreement to bring in an aspect of trade within a liberalized framework is generally a pro-active measure, which brings to bear the willingness and ability of the governments to face trading issues squarely in the eye. However, any agreement for trading benefits would be ineffective without the element of competition, both between enterprises and between States. The essential requisite for success in trading relations is competition, which in turn leads to national prosperity. A free trade agreement is merely the catalyst in the process.

The strongest thrust of globalization in the business world is its ability to generate competition within and between nations to offer the best goods and services at the lowest prices. The quality of services and pricing in China as an off-shore base have encouraged other nations, such as Malaysia, Thailand, Ireland, Vietnam, Brazil and Mexico to vigorously compete as viable off-shore bases.

*The World Is Flat: A Brief History of the Twenty-first Century*¹⁶ is a best-selling book which analyzes the progress of globalization with a focus on the early twenty first century. It was first released in 2005 and later released as an updated and expanded

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edition last year in 2006. The author, Thomas L. Friedman uses the metaphor of a flat world suggesting that the competitive playing fields between industrial and emerging market countries are leveling. This is both an interesting and real phenomenon. The woes of the air transport industry have always centered on the claim of most that aviation is effectively precluded from entering the free market due to government meddling. This seems to go contrary to the Keynesian view of the advantages of some degree of government control of the free market economy. Harsh restrictions on ownership and control of airlines and market access are stringent tools of government control. The argument for deregulation, as against government control, pervaded the economic crisis of 2008 where some argued that the bubble burst because the markets had not been free enough from government meddling and that the US Congress pushed lenders to have unfettered ability to lend to those who could not pay back their loans, leading to a housing bubble. Pankaj Ghemavat, referring to the 2008 bubble says:

Media magnate Rupert Murdoch blamed the Government for the debacle, stating: "It's very easy to blame the free market but how did we get to the housing bubble? We got it because of Congress pushing Fannie Mae and Freddie Mac into lending money to people who couldn't afford it and blowing up the price of housing...."¹⁷

In the air transport sector this principle is reversed in that governments meddle in fettering the freedom of air carriers by imposing political and economic restrictions. This trend seems to continue, much to the disappointment of the air transport industry. Anne-Marie Slaughter of Princeton University speaks of a new world order where the State will not be the only actor in the international system but will still be the most important actor; the State will not disappear but will disaggregate into its component institutions, which will increasingly interact principally with their foreign counterparts across borders; these institutions will represent distinct national or State interests, even as they also recognize common professional identities; and government networks will exist alongside and sometimes within more traditional international Organizations¹⁸. For air transport this is good news in that the State will not be the only actor in the international system.

B. ASAM and Air Transport Economics in Indonesia

In the 1960s and '70s, Indonesia followed a socialist ideology where air transport was exclusively conducted by two State owned enterprises : Garuda Indonesian and Merpati Nusantara airlines. The Ministry of Communications set regulations and there were no private air carriers that operated and there was no competition for the two carriers. The new order which followed under General Suharto was a mix between socialist and liberal ideology, introduced with Law No. 1 of 1967 which introduced

¹⁷ Economics has confirmed that aviation's contribution to the global economy supports 57 million jobs and some \$2.2 trillion in economic activity. Oxford Economics projected that aviation will grow about 5% annually to 2030. That would see passenger numbers rise to 5.9 billion and cargo shipments could triple to nearly 150 million tonnes. This connectivity would support 82 million jobs and \$6.9 trillion of global GDP. If growth is held back by even one %age point, the global economy would forfeit 14 million jobs and over \$1 trillion in GDP contribution from aviation. Aviation's benefits are not guaranteed. Aviation is expected to grow about 5% annually to 2030. If that growth is held back by even one percentage point, the global economy will forfeit over a trillion dollars and 14 million jobs.

¹⁸

foreign investments. This was followed by Ministerial Decree SK 13/6/1971 which allowed the creation of new airlines owned by private companies while the State owned Garuda International Airways controlled the trunk routes. An year earlier, Ministerial Decree 31/U/1970 allowed general aviation to operate under licence.

There was further relaxation under the regime of President Susilo Bambang Yudhoyono where private airlines grew. Regulation KM 81 of 2004 contained requirements for the establishment of new airlines followed by the *Law No. 1 of 2009 on Aviation* (The Aviation Law) which covered *inter alia* subjects such as sovereignty, aircraft operation, airworthiness of aircraft, safety, security and insurance. The Act also contains provisions on leasing, fares and liability of air carriers. However, it does not detail a clear policy on competition or air carrier access except to say that transparency and antimonopoly are the two guiding principles in aviation law in the country.

The philosophy of the 2009 Act is that it is not necessary to have too many airlines but existing airlines must be able to compete. This approach may place a burden on the main carriers operating at present but on the other hand, may also give them the impetus to compete with more versatile carriers in the region under ASAM. Airlines must have sufficient aircraft ownership; necessary capital investment; have a national majority holder; be supported by a bank guarantee and have the human resources capability to sustain the airline. New carriers must, in addition to providing a bank guarantee, prove that they own enough aircraft to support their operating licenses and hold a business permit. They must operate at least 10 aircraft (5 owned and 5 leased) if they are scheduled airlines and 3 aircraft (1 owned and 2 leased) in the instance of non-scheduled and all-cargo carriers.

Indonesia is in the Asia Pacific region which has grown the fastest among the regions in air transport. In particular, traffic within the region has grown very fast, according to an Airbus survey¹⁹. Asia Pacific's domestic traffic accounted for 36% of global domestic traffic and it is envisioned that revenue passenger kilometres will reach 52% by 2032. aircraft fleets of carriers in the region are the youngest in the world. The Airbus study states:

Projected future global network development in Asia-Pacific will have an important role in shaping the global network as a result of the dynamic air travel market in the region. Examining just the long haul routes, more than 50% of the new routes created between 2013 and 2032 will be connected to Asia Pacific. This gives a flavour of the dynamic nature of air transportation in the region²⁰.

In 2012, Indonesia was the 16th largest economy in the world, and it is forecast that in 2030 it will be 7th largest economy²¹. Then, it had 45 million members of the consuming class and in 2030 it will have 135 million. 53% of the population were then incities, which will increase to 71% of the population in 2030 and the number of skilled workers will double, from 55 million to 113 million, increasing market opportunity from \$0.5 trillion in 2012 to \$1.8 trillion in 2030²².

Indonesia is up to date with its technical requirements for the operation of aircraft. The regulators are taking a very positive stance at enhancing its standards on the

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²⁰ Farrar, Straus and Giroux: New York, 2006.

²¹ PankajGhemawat, World 3.0 – Global Prosperity and How to Achieve It, Harvard Business Review Press:2011 at 12.

²² Anne-Marie Slaughter, A New World Order, Princeton University Press:2004 at 18.

technical aspects of air transport. When one considers the doldrums Indonesia was in the year 2007, Indonesia has shown a strong come back with a conscious attempt to restore the industry's reputation. The Transportation Ministry has introduced a proactive system of safety rating, based on three levels: Level One indicating no serious issues; Level Two highlighting problems to be fixed; and Level Three enforcing the termination of flight operations. No airline at the introduction of this process came up to Level One ranking but at present all the country's airlines have reached Level One. The Ministry of Transportation insists on all airlines to be subject to the mandatory IATA Operational Safety Audit (IOSA) to be up to date with all operational management and control systems, particularly in view of new airlines coming into the business to meet capacity demand.

However, despite these encouraging facts and statistics, there are some challenges that Indonesian air transport may face with ASAM. One such challenge is with regard to aircraft type that will be used intra regionally by the larger carriers such as Singapore Airlines and Thai Airways International. In a liberalized market in South East Asia, aircraft type will be a considerable determinant of market share as the average passenger carriage in the region is about 150-200 passengers on a trip of around 400 nautical miles. This is much higher than in North America or Europe and therefore large aircraft, such as the A380 could be used effectively by the larger carriers at a good load factor on intra regional routes.

Another impediment for Indonesia in the global scene, and in particular the intra-regional ASEAN scene is that it is a closed economy with a tendency to be protective in the air transport field. As stated earlier, the apprehension in opening its skies is partly due to the tremendous domestic air traffic Indonesia generates, which offers potential to competitors in terms of connecting such traffic to international routes through sixth freedom carriage. To add to this disadvantage, Indonesian carriers do not offer expansive and regular services to Europe and North America compared to its ASEAN competitors, thus encouraging them to offer such connections on a sixth freedom carriage basis. One commentator refers to the Indonesian apprehension as follows:

This is the familiar operating model of major "sixth freedom" carriers worldwide such as Singapore Airlines, Emirates, KLM, Korean Air, Turkish Airlines and Qatar Airways. In essence, "sixth freedom" hub operations depend simply on two factors – a geographically strategic "hub" airport in the centre of airline routes to serve as a transit stop, and unlimited

third/fourth freedom rights to operate numerous "spokes" (hence, the alternative nomenclature of "hub-and-spokes" to describe the "sixth freedom").

Due to the Indonesian carriers' relatively limited international operations, most travellers from Europe, North America and Northeast Asia travel into and out of Indonesia on foreign carriers' sixth freedom operations. The largest operator in this regard is Singapore Airlines, which channels these travellers through its hub, Singapore Changi Airport. In recent years, the highly successful Malaysian low-cost carrier AirAsia has also begun to transport the budget-minded segment of travellers in this same manner through its hub at Kuala Lumpur International Airport. The discomfort with such sixth freedom operations accounts for Indonesia's reluctance to accept the ASEAN agreements...²³

²³ Airbus - Global Market Forecast - Future Journeys, 2013-2032, at 61.

Such dynamics have led the Indonesian government to propose only five points for an “open skies” policy - the major cities of Jakarta, Surabaya, Medan, Makassar and Bali.

Amidst the protests of the Indonesian carriers against open skies in the ASEAN region, and the cautious attitude of a “managed” protectionist stance to liberalization, the Indonesian authorities are sending a somewhat confusing and bullish message about the beneficial effects that ASAM might bring the country. One of the reasons for sanguinity could well be the growing Indonesian economy which will allow increasing numbers of the middle class to travel on business and tourism and the belief that the fast growing ASEAN region will be an added impetus in pushing demand for travel through ASAM²⁴.

One commentator is of the view that Indonesia needs a general overhaul of its philosophy that would enable the country to embrace a global perspective and ensure its rightful place in the world scene:

Traditionally, our nation’s place in the world has been framed by its leading role in Southeast Asia, similar to how Brazil was seen in relation to South America, South Africa to Africa and India to South Asia. With the inclusion of these four regional leaders in the G-20, Indonesia must prepare itself to take on a role that goes beyond national and regional concerns to include leadership on complex global issues.

Indonesia is expected to help shape the discourse on international issues — this makes the ability to bridge cultures critical. To this end, we need to move away from xenophobic sentiments that promote false perceptions of the world and perpetuate obsolete policies based on national insecurity. We need ideas that embrace globalization and place Indonesia in a position of influence. A solid group of foreign-educated citizens is essential to achieving this role²⁵.

This may well be the case, but in Indonesia’s defense, it must be stated that not all of Indonesia’s air transport has been parochial. There has been a conscious effort on the part of airlines of Indonesia to expand their business activities and improve on their business models. In 2010, Garuda Indonesia revamped its branding strategy by redesigning its corporate identity and launching a new service concept ‘The Garuda Experience’. This measure earned the airline the title ‘Most Improved Airline 2011’ and ‘World’s Best Regional Airline 2012’ from *SkyTrax*, a UK-based consultancy for in-flight research services. In the low-cost carrier segment, Lion Air became the largest client of Boeing in the Asia-Pacific region.

This has prompted one commentator to say:

*It is just a matter of time until Indonesia finally has one of world’s largest aviation industries. The country’s economic strength and growing middle class will continue to make it a strong market for air travel, with improved safety and infrastructure investment only adding to the industry’s potential.*²⁶

The above notwithstanding, the most troubling dichotomy faced by Indonesian aviation is that although Indonesia has a relatively high demand for air travel²⁷, its

²⁴ Ibid.

²⁵ Raoul Oberman, Richard Dobbs, Arief Budiman, Fraser Thompson, Morten Rosse, *The Archipelago Economy: Unleashing Indonesia’s potential* McKinsey Global Institute: September 2012 at 1.

²⁶ Ibid.

²⁷ Alan Khee-Jin Tan, *Toward a Single Aviation Market in ASEAN: Regulatory Reform and Industry Challenges*, Eria Discussion Paper Series, ERIA-DP-2013-22, at 12.

airports are in dire need of expansion²⁸ and infrastructure development if they were to come up to the standards of airports in other ASEAN region airports. Law No 1 of 2009 allows private investment in airports and this concession must be encouraged and pursued. Airports both in both the western and eastern regions need expansion. Secondary cities must be designated as alternative hubs that could ease the 70% of total traffic which now flows through Sukarno-Hatta Airport.

IV. Conclusion

Although ASEAN's ultimate aim is to forge, through ASAM, a truly single aviation market and strengthen its position with regard to market access for its airlines in other regions of the world, this dream may not be realized by 2015. Indonesia, with its strong reservations on unlimited third and fourth freedom rights for the giants of the region under open skies, and its weakened competitive ability with the large and forceful marketers of the region such as Singapore Airlines and Thai Airways International, may yet show a reluctance, and even a refusal to accept ASAM without reservation. Another glaring disadvantage of ASAM is that, unlike in the European Union's single skies, ASAM does not have a regulatory infrastructure in place together with established laws for competition policy, state aid, consumer rights and other areas, making the ASEAN open skies look very much like a "free for all". This would give the Indonesians more reason to be apprehensive of open skies in the region.

Ironing out ASAM to ensure that all players have a level playing field and that air services be operated in a fair and equitable manner²⁹ will take time, but eventually, if a deal acceptable to everyone can be struck, the benefits of an ASAM may outweigh parochial and protectionist interests. To use the words of the United States Department of State:

Direct air connections bring substantial economic benefits. Open Skies agreements expand cooperative marketing arrangements, liberalize charter regulations, improve flexibility for airline operations, and include provisions committing both governments to observe high standards of safety and security. These agreements also produce countless new cultural links worldwide³⁰.

One can only be hopeful that beyond 2015, the Indonesian carriers may have built their bases to an extent to be able to compete with other carriers. In the end, ASAM is not about protecting national carriers but forging economic growth in the region. It is about running with the flow, opening the ASEAN region to the world and cooperating with the major aviation players such as China with whom the ASEAN nations (including Indonesia as a signatory) have signed an air transport agreement. It would be up to the Indonesian authorities to weigh the balance between the interests of its overall economy, the development of the country and the benefits that would accrue to Indonesians, against and the national pride that the Indonesian carriers would bring the nation by carrying more Indonesian across the world than do other carriers.

²⁸I. Gusti Ngurah Irwan Dharmawan, *The Effect of Air Transport on Economic Development in Indonesia*, Paper submitted to the Erasmus School of Economics, Rotterdam, August 2012 at 21.

²⁹James Riady, *Top-Flight Foreign-Educated Graduates Can Help Indonesia Go Truly Global*, 10 January 2010, <http://www.livinginindonesiaforum.org/showthread.php/6197-What-s-wrong-with-Indonesia-amp-How-to-fix-it>

³⁰Michael O'Neill, *The Fall and Rise of Aviation in Indonesia*, October 9th, 2012. See <http://weber-shandwick.asia/the-fall-and-rise-of-aviation-in-indonesia/>

The World Bank has estimated that the population with disposable income forming the middle class in Indonesia will grow from 130 million people to 240 million by 2021. See Batari Saraswati and Shinya Hanaoka, Aviation Policy in Indonesia and its Relation to ASEAN Single Aviation Market, *Proceedings of the Eastern Asia Society for Transportation Studies*, Vol. 9: 2013 at 11.

Sukarno-Hatta Airport served more than 50 million passengers in 2012, more than twice its design capacity.

The Preamble to the Convention on International Civil Aviation provides, *inter alia* that Contracting States agree to certain principles that would ensure international civil aviation is developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically. See Chicago Convention, *supra*, note 11.