



OPEN SKIES WITH A CHANCE OF RAIN

How Indonesia can implement ASEAN Open Skies
within a region with infrastructural inequality

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Identify the issue

Indonesia is the largest country of the world consisting solely out of islands and that it has the most airports of all the non-American continents (CIA, 2014). With these facts in mind we can simply conclude that Aviation is the top facilitator for economic growth and welfare (ASEAN, 2012), not just for Indonesia but for the whole South East Asian Region. These countries are united in the Association of Southeast Asian Nations. Within the association a complete new aviation policy is made, to vague the borders and liberalize the routes within the region.

This deregulation brings great opportunities with it, to cite Maunu von Lueders, Regional Vice President Asia Pacific of IATA (2014): "Imagine a world in which the United States of America has to negotiate with Seoul to sell Apple product in South Korea. The South Korean will allow Apple to sell iPhones and iPads, but they won't be able to sell Mac Books. On the other hand Seoul demands that Samsung can sell their products in the USA, Washington will allow Samsung to sell the Galaxy S3 but they are not allowed to sell the S4. This sounds as a world hundred years ago without trade agreements, but actually this is how the aviation sector is working in the regions without Open Skies today."

This example shows the enormous leap forward the Open Skies agreements can generate, there

Summary

Growth is one of the first things we think about if we think about Indonesia and the South East Asian Nations, and growth it is, but if you want to grow you will need a starting point, a base point, a history. Growth is not the problem in Indonesia, as one of the BRIC countries is one of the most emerging markets in the world. In both economical, tourism and aviation wise. This however does not mean that their history is not important. It is their history that will be the risk factor in the possible growth and more specific in the economic growth resulting in an emerging aviation sector.

The implantation of open skies in the ASEAN region is a great opportunity but before

are some controversial sides to it however, especially for Indonesia. The nation's main gateway Soekarno-Hatta International Airport in Jakarta, has a capacity shortage already, the airport cannot expand on its current location which means that the complete airport has to move to the other side of the city. This means that the capacity of Soekarno-Hatta will not be expanded in the upcoming years until the new

"Imagine the USA had to negotiate with South Korea about selling Apple and Samsung products in their countries [...] that is how aviation in ASEAN looks like today." *Maunu von Lueders, Regional Vice President Asia Pacific of IATA*

Airport has been finished. The Airport assumes that the new airport will be fully operational in 2018, we as national government however doubt if that is reasonable. This means that the lack of capacity will be tackled, at best, 3 years after the implementation of the Open Skies Policy. This whitepaper describes the possibilities and threads the Indonesian aviation sector is facing with the combination of capacity shortage and deregulation.

implementing the policy and signing the covenant Indonesia will have to work on their infrastructure and getting up with the more "western" countries like Malaysia and Singapore. If they cannot solve the capacity problems and they sign the agreements under pressure of the region the risk of losing grip on their own aviation sector with losses of the national aviation sector as a result. The market could be taken over by Singapore with Singapore Airlines and Singapore Airport as hub and Malaysian Airways with several international airports as "alien-domestic-hubs".

Realization of ASEAN Open Skies

The Open Skies agreements in ASEAN are based on two agreements: the Multilateral Agreement on Air Services (MAAS) from 2009 and the 2010 Multilateral Agreement on the Full Liberalization of Passenger Air Services (MAFLPAS), together with other protocols these agreements combined result into the Open Skies policy or Single Aviation Market (SAM). The main message in these agreements and protocols is that the capital and peripheral cities of the ASEAN countries will have the unlimited right for the third fourth and fifth freedom rights. This means that any airline from one of the ASEAN nations has the right to fly from their home capital city towards any other ASEAN capital city and back. It has the right to fly from its home capital city to any other ASEAN capital city and then on to a third ASEAN capital city (Australian AID, 2011). The second agreement provides unlimited third, fourth and fifth freedoms for all the 72 international airports in ASEAN (Maybank Kim Eng, 2013). The seventh right and further, cabotage and grand cabotage are not taken into the agreements. The large change between the current situation and the future open skies is that Indonesia and most other ASEAN states have limited the frequency and capacity of those routes, with the open skies becoming operational the operations between the capital cities will be unlimited.

Deregulation: good for all?

Several other parts of the world have been liberated before the ASEAN-region, the United States at first and after the USA the European Union and Australia and New Zealand (Tasmania) have made multilateral agreements which consist unlimited travel and deregulation of the aviation market.

Although all the regions have been deregulated there are big differences, firstly the United States aren't a pact of nations but one nation

According to the President Director of the PT Angkasa Pura II, the operator of Jakarta Soekarno-Hatta International Airport: "The need for a physical expansion of the country's busiest international airport is imminent as WII is already serving almost double its capacity of airline passengers." (Broeders, Horn et. al, 2014a). This means that the airport has a capacity of 30 million annual passengers (MAP) while it is serving over 60 million passengers annually. On top of this a growth of fifteen to twenty million passengers annually is forecasted (Broeders, Horn et. al, 2014a) before the new airport opens.

With these facts in mind, a simple calculation shows that during the first three years of the Single Aviation Market, gap between reasonable capacity and demand will be up to 50 million passengers in 2018. The danger lies in the chance that there is not enough capacity anymore to maintain the feeder flights for the international destinations of the airport. A conceivable scenario would be the KLM Cityhopper system, KLM Cityhopper makes good use of the capacity shortages of London Heathrow Airport by flying to regional airports in the United Kingdom and transferring the passengers via Amsterdam Schiphol to destinations all over the world (anonymous, 2008). This is a serious risk for Indonesia and the state owned airline Garuda Indonesia.

with one government. The EU and Tasmania which are pacts of nations. The European Union has a single regulator for the whole union while in Tasmania the legislation is jointly developed just like ASEAN. The final difference is that the EU and the Trans Tasmanian markets have implemented all the Freedoms of the air, while the ASEAN region will only implement the third, fourth and fifth freedom. So far the differences,

although this difference we still can learn lessons from these other Open Skies initiatives.

If we take a look to those markets which underwent deregulation, we see that the results are positive for the consumers and employees. The competition increased in both the EU and Tasmania and lots of startups in the airline industry were registered. This resulted into lower prices, more passengers, a large choice of routes and carriers, and better service.

The deregulation has also led to lower market shares of the historic home carriers. While the Low Cost Carriers (LCCs) started growing rapidly, since the deregulation in the USA the market share of Low Cost Carriers have been grown to 30% of the market, while in Europe the Low Cost Carriers became even bigger with 40% of the market share. The traditional Full Service Carriers (FSCs) had to adapt to this. They have done this by focusing more on the international passenger and the hub-and-spoke system. And forming alliances with other carriers to create a world covering network.

Indonesia is the largest economy of the ASEAN-group, with an Annual GDP of over 860 United States Dollars, and a population of more than 250 million people, besides that Indonesia is, as only ASEAN-nation part of the G20 of largest economies. In 2011 Indonesia was the 27th largest country in export just over Norway and Poland, a lot of export products goes to the US, China, Brazil and Russia. The most shipped products are natural resources like oil, rubber, cotton and coffee, besides that the automotive industry is the production of electronic product contribute for quite a large share to the export of the republic (Anonymous, 2011).

Besides that the tourism sector contributes for about 9 billion US Dollars to the GDP. Especially the tourism sector demands a very strong and reliable aviation sector.

The economic forecasts show further growth of five to six percent annually and a stabilization of the political playfield.

Indonesia grew its economic contribution from Travel & Tourism by 8.4% in 2013, the largest growth of any G20 country. That is according to the latest research from The World Travel & Tourism Council (WTTC), the global authority on the Travel & Tourism Industry.

WTTC's 2014 annual Economic Impact Report shows that Indonesia recorded double digit growth in international visitor spending (15.1%) and 7.2% economic growth in domestic tourism last year.

The growth of the Indonesian Tourism market is laid down very complete by David Scowsill, President and CEO of WTTC (2014), he said:

"It has been a fantastic year for Travel & Tourism in Indonesia; "Indonesia is expanding its economy rapidly and, as a result, the burgeoning middle class is travelling for business and leisure. The country is also experiencing an expansion in international visitors bringing valuable export income to the country, partly encouraged by the devaluation of the Indonesian rupiah against the US dollar. As the country moves from agriculture to a service-based economy, Travel & Tourism is increasing and the economy overall is reaping the rewards".

In 2014, WTTC's research shows that Travel & Tourism's direct contribution to the Indonesian economy is expected to grow by a further 8.1%, outperforming the general economy by 2.8 percentage points. WTTC's 2014 forecasts predict double digital growth for international visitor exports (14.2%) and continued above average growth for domestic tourism spending (6.3%).

Mr. Scowsill continues; "2013 was a great year for Travel & Tourism. But 2014 is set to see a further boom in visitor numbers, tourism receipts and job creation. If Indonesia continues to invest in promotional activity and bring in visa facilitation policies, it is set to again be one of the winners for Travel & Tourism this year. It is vital, however, that such impressive growth goes hand in hand with policies to ensure the future sustainability of

the sector. Indonesia has many natural and cultural riches and these need to be protected for the future”.

However, Mr. Scowsill reminds Governments that they need to take action; “Travel & Tourism forecasts over the next ten years also look extremely favorable, with predicted growth rates of over 4% annually that continue to be higher than growth rates in other industries. Capitalizing on the opportunities for this Travel & Tourism growth will, of course, require destinations and regional authorities, particularly those in

emerging markets, to create favorable business climates for investment in the infrastructure and human resource support necessary to facilitate a successful and sustainable tourism industry. At the national level, governments can also do much to implement more open visa regimes and to employ intelligent rather than punitive taxation policies. If the right steps are taken, Travel & Tourism can be a true force for good”.”

Largest market, largest share?

The strength of the Indonesian market is their domestic market, the nation consists out of hundreds of islands, and it is even the largest archipelago in the world. This makes aviation the main mobility for inland travel. The importance for aviation can be shown by the amount of airports and international airports in Indonesia, the amount of airports is 673, and this makes Indonesia the tenth nation in the world airport wise. Of these 673 airport 26 are international airports this is with 36% the largest share of international airports in the ASEAN-region.

Also the suspected growth in tourism and economy are great drivers for aviation. Especially the growth in tourism will drive the aviation to higher growth numbers.

The largest weakness of Indonesia is the cohesion and the bad infrastructure of their main airport: Soekarno-Hatta International Airport. As has been discussed above the airport has a real capacity shortage, the plans are laid down to fulfill this shortage but with an increase of 100% of the designed capacity this is already too late. The airport has plans to rebuilt the airport on another location to expand their capacity (Broeders, Horn et. al., 2014), but these plans will be realized, according to the project team in 2018, this is three years after the implementation of the open skies policy. Those three years will be three crucial years for the aviation in Indonesia, in these years the tread of

foreign airlines who will become creative with the fifth freedom of the air. This fifth freedom allows foreign airlines to fly from their home country to a country abroad and then on to a destination in a third country. This fifth freedom creates possibilities to be creative for foreign airlines to operate without the sixth, seventh, eight and ninth freedoms.

The following two phrases from the Multilateral Agreement on Air Services (ASEAN, 2009) show describe these possibilities:

“The designated airline(s) ... shall, ... be allowed to operate from any points in the territory of the Contracting Party designating the airline via any intermediate points to any points in the territory of any other Contracting Party and to any points beyond in any combination or order, provided that all the points are international airports.”

“Paragraph 1: Each designated airline may, on any or all flights and at its option: ..., c) Serve behind, intermediate and beyond points and points in the territories of the Contracting Parties on the routes in any combination and in any order, without directional or geographic limitation and without loss of any right to carry traffic otherwise permissible under this Agreement, provided that the service serves a point in the territory of the Contracting Party designating the airline.”

The Maybank Kim Eng (2013) stated about this creativeness: "This opens the door to a plethora of flight combinations that connects all the international airports scattered across the region. For example, an airline in Malaysia could service Kuala Lumpur – Yangon – Singapore, or Kuala Lumpur – Hanoi – Phnom Penh, or Kuala Lumpur – Singapore – Ho Chi Minh City. The possibilities are endless, and we suspect all major trunk routes will see an explosion of services by the major carriers."

Conclusion

The implementation of open skies will have different impacts in all the different sectors, in this section we will consider the following sectors: consumers, airlines, airports and infrastructure and the government.

The impact on the consumers, both Indonesian citizens as well tourists from all over the world travelling from and toward Indonesia will merely positive effects. The fares will go down, the competition between airlines will strengthen and the supply and frequency of flights will grow. New airlines will arise, especially in the Low Cost sector new airlines will start operating. Furthermore Full Service Carriers will merge and start alliances and partnerships to make the best use of their own home states and the restricted open skies policy in the ASEAN region. The Full Service Carriers will anyway suffer the most from the deregulation because their playfield is now highly restricted and protected for new entrants and foreign competitors. Although there are possibilities for the Indonesian carriers to expand to new markets and improve their influence in the region.

The danger however we find in the airports in the nation, these are outdated and especially in Jakarta very congested. Here Indonesia has to do a lot of work before signing the covenant, if the airport congestion and under capacity is not solved before implementing the Single Aviation

The Open Skies agreements give a great opportunity to grow in all possible directions. New airlines, of which a lot Low Cost airlines, will arise if the routes will be liberated. This can be foreign airlines who will operate intra-ASEAN flights. But a more positive result would be that the competition within Indonesia will become stronger. More domestic Low Cost Carriers could arise and fares might drop.

This scenario has been the biggest difference after the deregulation in the European Union and the United States of America.

Market, there is the risk that, where now Jakarta is the hub to connect all the Indonesian airports with each other and the outer world, this place as national hub is taken over by one or more foreign airport or airports.

If we take a look to the geographic position of the airports in the region Malaysia and Singapore could serve the island of Sumatra (50 million inhabitants). Malaysia has also the geographical compared to Sulawesi (17 million inhabitants) and (14 million inhabitants). Malaysia and Singapore have both strong international operating airlines with Malaysian and Singapore Airlines and a great network of technically up to date and non-congested airports ready to take over a better market position in the region.

These two countries have therefor signed all the declarations already. Indonesia on the other hand has only signed the first initial declaration but did not confirmed itself onto the real Multilateral Agreement on Air Services and the 2010 Multilateral Agreement on the Full Liberalization of Passenger Air Services. It seems to be a smart step to keep this out of the door, but the question that directly arises is: 'can Indonesia hold this position under pressure of the region, when they are going on?' or will they get excluded by the other Airlines. Because of the size of the Indonesian market, they still have the largest market (potential), this is not a very properly scenario but it is to advice to the Indonesian government that they trying to catch

up with the pace of liberalisation as soon as possible, although the speed of deregulation in the region is admirable, but not before they have their infrastructure on an appropriate level so

they can manage the enlarged market and keep the market share home carrier Garuda Indonesia in their own hand.

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