



This Technical Paper is published with the WAYPOINT November 2018 report and discusses issues relating to the air traffic rights and airline nationality requirement under air services agreements.

EXECUTIVE SUMMARY

Air services agreements (ASAs) are treaties entered into by States to govern international air transport and define the commercial rights granted by the States to their airlines to fly over and within their territories. This paper discusses the different approaches adopted in the ASAs, focusing on the provisions regarding air traffic rights (ATRs) and airline nationality requirement. ASAs and these two specific elements are important factors that determine the openness of a State in terms of international air transport, which in turn, would affect the State's connectivity.

There are more than 2,900 bilateral ASAs worldwide. Currently, more than 75% of these ASAs are "traditional" ASAs, providing limited and heavily regulated ATRs. Similarly, for Malaysia, a majority of its 106 bilateral ASAs are traditional ASAs providing third and fourth freedom rights, as well as limited fifth freedom right. Meanwhile, for the Association of Southeast Asian Nations (ASEAN), its Single Aviation Market agreements and protocols provide for intra-ASEAN fifth freedom and domestic code-share rights. The agreements also provide for the possibility of ASEAN community carriers in the future. Indeed, the liberalisation of ASEAN—a region with a population of more than 600 million and growing economies—is a priority to ASEAN Member States, including Malaysia.

Thus, it is vital for Malaysia to develop its future aviation policies to keep up with the international and regional developments. At the international level, since the first US-Netherlands "open skies" ASA in 1992, more States have sought for liberal ASAs to grant more extensive ATRs and commercial freedom to airlines to exercise those rights, subject to competition law. As for ASEAN, it is pursuing the liberalisation of civil aviation intra-regionally and externally with its Dialogue Partners, such as China and the European Union.

Finally, Malaysia's future aviation policies should also be aligned with the nation's connectivity and economic objectives to further enhance the growth of its civil aviation industry. Previously, ASAs might have been concluded with certain countries to pursue general diplomatic relations objectives, rather than to address specific industry or passenger needs for air connectivity. Moving forward, Malaysia needs to be more strategic in negotiating ASAs to ensure greater utilisation of these agreements by limiting the mismatch between their market access and demand by carriers and consumers.

In view of the above developments and objectives, serious consideration should be given to the further liberalisation of Malaysia's ATRs and airline nationality requirement.

Abbreviations

Abbreviations

Act 771	Malaysian Aviation Commission Act 2015
ASA	Air Services Agreement
ASEAN	Association of Southeast Asian Nations
ATR	Air Traffic Right
AUD	Australian Dollar
CAGR	Compound Annual Growth Rate
CRS	Computer Reservation Systems
EC	European Commission
EEA	European Economic Area
EU	European Union
FSC	Full-service Carrier
GDP	Gross Domestic Product
IATA	International Air Transport Association
ICAO	International Civil Aviation Organization
km	Kilometre
LCC	Low-cost Carrier
MAAS	ASEAN Multilateral Agreement on Air Services
MAFLPAS	ASEAN Multilateral Agreement on the Full Liberalisation of Passenger Air Services
MAVCOM	Malaysian Aviation Commission
MOT	Ministry of Transport, Malaysia
MYR	Malaysian Ringgit
NZD	New Zealand Dollar
O&D	Origin and Destination
SAARC	South Asian Association for Regional Cooperation
UAE	United Arab Emirates
UK	United Kingdom
US	United States
WASA	Database of the World's Air Services Agreements
WTO	World Trade Organization

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INTRODUCTION

International air transport is built on a network of treaties between countries that are commonly known as ASAs. The ASAs are government-to-government agreements that define the commercial rights granted by States to designated airlines to provide aviation services between the territories of the States. The commercial rights cover the ATRs, as well as any other conditions attached to the operation of such rights, such as the determination of capacity and tariffs (airfares) for the agreed services and the ownership of the airlines. These ASAs provide the legal basis for the provision of international scheduled services¹, in particular, which served an approximate 1.7 billion passengers worldwide in 2017². Even though there are regional or plurilateral ASAs, a large majority of ASAs are bilateral in nature. As at August 2018, there were 2,913 bilateral ASAs registered with ICAO³. Malaysia alone has entered into 106 bilateral ASAs.

For Malaysia, the negotiation of ASAs falls under the purview of the MOT. MAVCOM's functions in relation to the ASAs are two-fold: MAVCOM is responsible for providing advice and recommendations to the MOT from an economic perspective, particularly on matters relating to its functions under Act 771; and, in performing its functions, MAVCOM shall have regard to any international agreement to which Malaysia is a party and not act contrary to the international obligation or the interest of Malaysia⁴. Additionally, MAVCOM is responsible in administering, allocating, and managing ATRs, including international ATRs procured under ASAs.

This paper seeks to cover the different approaches adopted by States in terms of ATRs and airline ownership in relation to international scheduled air services. This paper has four main sections:

- Section 1 discusses the economic development of international air transport under the Chicago Convention and ICAO.
- Section 2 analyses the different approaches in terms of ATRs and capacity adopted by States, including the positions taken by Malaysia in its bilateral and regional ASAs. This section further looks at the effects of the liberalisation of ATRs.
- Section 3 focuses on the airline nationality requirement in relation to the designation and authorisation of airlines under the ASAs and domestic regimes. This section also discusses the issues arising from the airline ownership requirement and its liberalisation.
- Section 4 analyses key developments and future trends relating to ATRs and airline ownership, highlighting the continuous liberalisation efforts by States, the emergence of the community carriers, and the increasing importance of competition issues following the liberalisation of ATRs and airline ownership.

¹ While some ASAs do govern international non-scheduled services, they are mainly governed by rules laid down by individual States.

² ICAO (2017).

³ ICAO WASA.

⁴ Section 17(3) of Act 771.

SECTION 1: ECONOMIC DEVELOPMENT OF INTERNATIONAL AIR TRANSPORT

ICAO is a United Nations specialised agency that was established by the Convention on International Civil Aviation, commonly known as the Chicago Convention. The Chicago Convention was signed on 7 December 1944 by 52 States and officially entered into force on 4 April 1947⁵.

The Chicago Convention forms the foundation of modern international civil aviation. Other than establishing ICAO, the Chicago Convention also codifies the underpinning principles and arrangements for the safe and orderly development of international civil aviation, and the establishment of international air transport services on the basis of equal opportunity, as well as economical and sound operation. ICAO currently has 192 Member States⁶.

ATRs under the Chicago Convention

The Chicago Convention contains the principles relating to the provision of air transport by an airline of a State through or in the territory of another State. These rights are mainly contained in Article 5 (on non-scheduled flights), Article 6 (on scheduled flights), and Article 7 (on cabotage). These provisions were developed based on the established international law principle which recognises that every State has complete and exclusive sovereignty over the air space above its territory⁷. Pursuant to that principle, the Chicago Convention recognises the differing rights of a State regarding scheduled and non-scheduled international air services, as well as cabotage services.

For the purpose of this paper, the following discussion focuses on Articles 6 and 7 of the Chicago Convention which govern scheduled flights and cabotage services, respectively.

Scheduled Flights

Article 6 of the Chicago Convention provides that no scheduled international air services may be operated over or into the territory of a State, except with the permission or authorisation of that State, and in accordance with the terms of such permission or authorisation⁸. Thus, an airline of a State has no inherent right to operate scheduled international air services over or into the territory of another State.

Article 6 of the Chicago Convention is the basis on which ASAs are negotiated and entered into by States. Essentially, ASAs spell out the terms of the permission or authorisation of States for the operation of scheduled international air services over or into their respective territories.

⁵ ICAO (2017).

⁶ List of ICAO Member States.

⁷ Article 1 of the Chicago Convention.

⁸ As per Article 96 of the Chicago Convention, “international air service” refers to any scheduled air service performed by aircraft for the public transport of passengers, mail or cargo which passes through the air space over the territory of more than one State.

Cabotage

Cabotage services in terms of air transport refers to the taking on of passengers, mail or cargo, for remuneration or hire, from one point to another point within the territory of a State by an airline of another State. Article 7 of the Chicago Convention provides that each Contracting State has the right to refuse permission to another State's aircraft to provide cabotage services within the Contracting State's territory. Thus, while cabotage is not prohibited by the Chicago Convention per se, it recognises the right of States to refuse cabotage to any foreign aircraft.

The second sentence of Article 7 of the Chicago Convention further provides that each Contracting State undertakes not to enter into any arrangement which specifically grants cabotage privilege on an exclusive basis to any other State or an airline of any other State, and not to attain any such exclusive privilege from any other State. This provision has resulted in some ambiguity as to its meaning.

One interpretation is that, if one State gives cabotage privilege to the aircraft of another State, it must do the same to the aircraft of all States. This is similar to the most-favoured-nation treatment in international trade agreements under the WTO. An alternative interpretation is that a State may give cabotage right to the aircraft of another State, provided that the former is not prohibited from providing cabotage right to any other State as it sees fit. Sweden had proposed to the ICAO Assembly for the deletion of this provision as, it argued, the ambiguity removes the freedom of States in negotiating the exchange of commercial rights. However, Sweden's attempts in 1968 and 1971 to delete the second sentence of Article 7 of the Chicago Convention had failed⁹.

Despite the retainment of the second sentence of Article 7, it appears that the second interpretation has prevailed. This is supported by the fact that cabotage right has been granted in at least 12 ASAs¹⁰ worldwide, such as the Australia-New Zealand ASA and the Malaysia-UK ASA. The prevailing understanding is that such ASAs do not breach Article 7 of the Chicago Convention so long as they do not contain any provision that prohibits the Parties to the agreements from offering cabotage rights to any other States.

⁹ An amendment to the Chicago Convention is generally considered appropriate when it is proven to be necessary by experience and/or it is demonstrably desirable or useful. States that objected to Sweden's proposal to amend Article 7 (such as Congo, Italy, Kenya, Peru, Romania, and the UK) viewed that there was little or no evidence to show that the alleged ambiguity of the second sentence of Article 7 had caused difficulties to any State other than Sweden (Gertler, 1974; ICAO Assembly, 1971).

¹⁰ ICAO WASA.

Box 1. The Absence of a Multilateral Arrangement for the Economic Development of International Air Services

As mentioned in the Introduction section, the commercial rights for international air services are provided mainly by thousands of bilateral ASAs. For the aviation sector which is very much international in nature, the absence of a widely-ratified multilateral agreement to provide for commercial international air transport is notable, especially since the technical aspects of international aviation are regulated multilaterally by ICAO. As for commercial rights for international air transport, the Chicago Convention generally leaves such issues to the States to address, which they have done by entering into ASAs with each other.

Failed attempts to create a multilateral ASA

The proliferation of ASAs at the bilateral level (and to a lesser extent, at the regional level) stems from the failure of States to agree on a multilateral agreement encompassing commercial rights for international air transport. Attempts to establish such a multilateral agreement were made at the Chicago Conference in 1944¹¹ and the Geneva Commission (under the auspices of ICAO) in 1947. Both attempts failed due to the States' diverging views on issues such as the grant of ATRs, and the determination of routes, capacity, and airfares.

As one of the proponents for the multilateral approach for international commercial air transport, Canada contended that it would create a set of clear and non-discriminatory conditions that apply to all airlines, preventing future frictions between States that might lead to war¹².

Peru summarised the difficulties of accepting a multilateral agreement as emanating “from the different stages of development in commercial aviation among various nations, from the different aeronautical potential of each country, from the variations found when considering each country in international air transport, according to its climatic or geographical conditions and lastly, what is more important, the substantial difference between the countries already in commercial aeronautics, and these countries, such as ours, which can only look to the future”¹³.

¹¹ At the end of the Chicago Conference, the International Air Service Transit Agreement and the International Air Transport Agreement were signed together with the Chicago Convention. The International Air Service Transit Agreement provides for only the first and second freedom rights, while the International Air Transport Agreement seeks to grant the third, fourth and fifth freedom rights. The International Air Transport Agreement failed to gain wide support by States, with only 17 signatories and the subsequent withdrawal of certain States including the US. At present, this agreement only has 11 Parties: Bolivia, Burundi, Costa Rica, EL Salvador, Ethiopia, Greece, Honduras, Liberia, the Netherlands, Paraguay, and Turkey (ICAO, 1944).

¹² ICAO Doc 4510, AI-EC/72, May 1947, 35.

¹³ ICAO Doc 4510, AI-EC/72, May 1947, 45 – 46

Ultimately, States could not agree on the content of a multilateral agreement on commercial aviation rights¹⁴. For example, at the 1947 Geneva Commission, States such as Australia, Brazil, Colombia, Egypt, Greece, Italy, India, Mexico, New Zealand, Portugal, and Turkey viewed that even if a multilateral agreement providing for the third, fourth, and fifth freedom rights is established, a State should be free to enter into an agreement with another State to deny or vary the fifth freedom right between the two States. On the other hand, Denmark, France, Ireland, the Netherlands, Norway, Sweden, Switzerland, the UK, and the US opposed such position, which was viewed as having the effect of vitiating the value of the multilateral agreement¹⁵.

Due to the irreconcilable differences between States at the Chicago Conference and the Geneva Commission, the attempts to establish a widely-accepted, multilateral agreement governing commercial rights for international air transport failed.

Instead, States proceeded to pursue those rights bilaterally, and in more recent times, regionally.

ICAO's current effort to liberalise air transport via multilateral agreements

More recently, ICAO has initiated the effort to liberalise market access and foreign investment restrictions in international airlines at the multilateral level in 2014, which is still ongoing. The aim is to develop liberalised multilateral agreements for signature by States that are “willing and ready”, while other States are free to join the treaty when they are ready and comfortable to do so. It is unclear when the multilateral agreements would materialise. Thus far, States remain divided on fundamental issues such as the scope and pace of liberalisation under such multilateral arrangements, and the need for safeguard provisions¹⁶.

¹⁴ On the failure to establish a widely-supported multilateral agreement on commercial rights for international air transport, Dr. Edward Warner, who was the President of the ICAO Council, commented that, “Everyone wants a multilateral agreement; but unfortunately, there are wide differences of opinion... about what the agreement should contain...” (IATA Bulletin, No. 15 (1952)).

¹⁵ McClurkin (1948); ICAO (1948).

¹⁶ ICAO (2017).

ICAO and the Economic Development of International Air Transport

ICAO's role in the economic development of international air transport is rooted upon Article 44 of the Chicago Convention. Article 44 prescribes ICAO's main objectives as two-fold: to develop the principles and techniques of international air navigation; and to foster the planning and development of international air transport (including economic development)¹⁷. In respect of the latter, amongst the aims of ICAO are to —

- ensure the safe and orderly growth of international civil aviation throughout the world;
- meet the needs of the peoples for safe, regular, efficient, and economical air transport;
- prevent economic waste caused by unreasonable competition;
- ensure that the rights of Contracting States are fully respected and that every Contracting State has a fair opportunity to operate international airlines; and
- avoid discrimination between Contracting States¹⁸.

Unlike the safety, security, and technical aspects of air transport where ICAO sets the standards to be followed by the States, ICAO does not have rule-making powers on the economic aspects of international civil aviation. This stemmed from the failure of States to agree on ICAO having any rule-making function over the economic aspects of international civil aviation during the Chicago Conference. Instead, ICAO plays a role in fostering the development of a sound and economically-viable civil aviation system by providing guidance on and harmonising economic policies of international air transport, in line with Article 44 of the Chicago Convention¹⁹. Despite ICAO's role and influence in the economic development of international air transport, ultimately, the States retain their policy-making powers in terms of the economic aspects of international air transport.

ICAO Template ASA

Background of the ICAO Template ASA Provisions

As mentioned above, following the failure to establish widely-accepted multilateral agreements to govern commercial aviation rights, States have entered into bilateral ASAs to provide for those rights. Amongst the earliest bilateral ASAs following the Chicago Convention were the US-Sweden ASA (1944), the US-UK ASA (1946), the US-Netherlands (1957), the US-Australia ASA (1957), and the UK-Ethiopia ASA (1958).

¹⁷ Article 44 of the Chicago Convention.

¹⁸ Article 44 of the Chicago Convention.

¹⁹ <https://www.icao.int/about-icao/Council/Pages/Strategic-Objectives.aspx>, accessed on 3 September 2018. In relation to ICAO's Strategic Objective on Economic Development of Air Transport, ICAO also seeks to enhance economic efficiency and transparency while facilitating access to funding for aviation infrastructure and other investment needs, technology transfer, and capacity building to support the growth of air transport and for the benefit of all stakeholders, (<https://www.icao.int/sustainability/Pages/default.aspx> accessed on 3 September 2018.)

Historically, nearly all airlines were State-owned and the commercial aspects of civil aviation was heavily regulated including ATRs, the designation and authorisation of airlines, capacity, and airfares. Subsequently, States began to liberalise the commercial rights provided under ASAs. The most liberal ASAs are commonly known as the open skies agreements, which generally provide for liberal ATRs with no limitations in terms of routes, number of designated airlines, capacity, type of aircraft, and the free determination of tariffs²⁰. The move towards the open skies agreements was pioneered by the US-Netherlands ASA, which was signed in 1992. Since then, the US had entered into open skies agreements with more than 120 States²¹. Other States such as the UK, Singapore, Australia, and New Zealand have also followed suit by entering into increasingly liberal ASAs with other States.

In light of these developments, ICAO saw a need to develop a Template ASA to facilitate liberalisation by providing guidance to States in negotiating ASAs and harmonising the ASAs in terms of their language and approach. The ICAO Template ASA was given wide support by States at the ICAO's Fifth Air Transport Conference in 2003²².

The ICAO Template ASA contains a comprehensive framework agreement with provisions reflecting the traditional, transitional, and liberal approaches to the various elements of an ASA. The template is meant to be a living document that will continue to be updated periodically²³.

The use of the ICAO Template ASA is optional for States. States are free to choose different approaches for different provisions in the template, allowing them to shape agreements that suit their domestic policies, interests, and level of development, while moving towards expanding liberalisation in the international civil aviation markets. States could also identify potential areas and formulae for liberalisation by comparing their existing agreements with the ICAO Template ASA. For example, Malaysia has developed its own template ASA based on the ICAO Template ASA to provide internal guidance to its negotiators.

²⁰ US Department of State (2017).

²¹ As described in Table 1, "open skies" agreements fall within the category of "full liberalisation" ASAs.

²² Appendix 5 of the Policy and Guidance Material on the Economic Regulation of International Air Transport, Document 9587, ICAO (2008).

²³ ICAO is currently updating Document 9587.

Overview of the ICAO Template ASA Provisions

The ICAO Template ASA covers a wide range of provisions relating to international air services encompassing the safety, security, and technical aspects on one hand, and the economic aspects on the other hand. It also provides different approaches to cater for the different policies and levels of development amongst States.

Based on the different approaches adopted by the States, ICAO loosely classifies bilateral ASAs into three general categories: traditional, transitional, and full liberalisation. Table 1 shows ICAO's general description of the ASA categories, examples of ASAs, and the number of ASAs according to such categorisation.

Table 1: Type, Number, and Examples of Bilateral ASAs

Type of ASA	Description and Example	No. of ASAs
Traditional	An agreement that provides for single or multiple designation, predetermination of capacity, and dual approval of tariffs Examples: Australia-Brazil ASA (2010); India-Brunei ASA (1995); and Malaysia-Mexico ASA (1992)	2,207
Transitional	An agreement that contains one or more of the liberal elements described in the row below Examples: Malaysia-Ireland ASA (1992); Sri Lanka-UK ASA (1998); and New Zealand-Austria ASA (2002)	474
Full liberalisation	An agreement that provides for the following liberal elements: unrestricted ATRs (covering a minimum of the third, fourth and fifth freedom rights); multiple designation with no route limitations; free determination of capacity; and dual disapproval, country of origin or free-pricing tariff regime Examples: Australia-New Zealand ASA (2002); Malaysia-UK ASA (2013); and Malaysia-US ASA (1997)	232

Source: ICAO WASA

As mentioned previously, the ICAO Template ASA provides for different formulations of the ASA provisions according to the traditional, transitional or full liberalisation approach. Table 2 provides the overview of the general elements found in the ICAO Template ASA based on the different approaches.

Table 2: ICAO Template ASA Provisions

Elements	Traditional	Transitional	Full Liberalisation
Grant and exercise of ATRs	Up to the fifth freedom rights between specified points	Up to the seventh freedom rights between any points	Up to the fifth freedom rights between any points
	Predetermined capacity	More freedom to determine/increase capacity	Free determination of capacity
	Single designation	Multiple designation	Multiple designation
	Tariffs subject to double approval	Tariffs subject to country of origin or double disapproval principle	Tariffs subject to competition law
	Change of gauge/ aircraft subject to strict conditions	More flexibility to exercise change of gauge/aircraft	Free to exercise change of gauge/ aircraft
	-	Codesharing/ cooperative arrangements are limited to designated airlines and restricted by route or number of flights	Codesharing/ cooperative arrangements with any airline subject to obligation to inform consumers
	Schedule subject to approval	-	-
Authorisation	Substantial ownership and effective control	<ul style="list-style-type: none"> • Substantial ownership and effective control; or • Principal place of business and effective regulatory control 	Effective regulatory control
Aircraft leasing	Aircraft leasing from another airline of a Party or any non-airline source is allowed, subject to conditions and prior approval by both Parties	<ul style="list-style-type: none"> • Dry lease from any company is allowed, subject to safety and security requirements; and • Wet lease from airlines of a Party or a third country is allowed, subject to conditions 	Any aircraft leasing arrangement is allowed, subject to safety and security requirements

Elements	Traditional	Transitional	Full Liberalisation
Competition	Fair opportunity to operate	<ul style="list-style-type: none"> • Fair and equal opportunity to compete; and • Eliminate discrimination or unfair competitive practices that adversely affect competition 	Fair competitive environment under the competition laws
	-	Exchange of information, consultation, and cooperation relating to competition laws, policies or practices	
	-	Prohibition of unfair competitive practices (in particular, abuse of dominance) as safeguards and related procedures	
Ground handling	Right to use the ground handling services of a designated airlines of the other Party on the basis of reciprocity	<ul style="list-style-type: none"> • Right to choose from competing ground handling service providers; or • Right to perform self-handling, have ground handling services provided by any agent authorised by the authority of the other Party, and provide such services to other airlines 	<ul style="list-style-type: none"> • Right to perform self-handling; • Right to provide ground handling services to other airlines; • Right to form an entity to provide ground handling services; and • Right to choose from competing ground handling service providers
Intermodal services	Allowed, subject to approval by both Parties	Allowed for cargo	Allowed for cargo and passengers
Statistics	Mandatory furnishing of statistics or upon request	Furnishing of statistics upon request	-
Safety and security	Mutual recognition of certificates of airworthiness, certificates of competency, and licenses		
	Obligations and procedures relating to safety standards		
	Obligations and procedures relating to aviation security		
	Obligations relating to security of travel documents		

Elements	Traditional	Transitional	Full Liberalisation
Non-national personnel and access to local services	Right to bring into and maintain commercial, operational, and technical staff in the territory of the other Party, subject to the laws and regulations		<ul style="list-style-type: none"> • Right to bring into and maintain managerial, commercial, operational, technical, and other specialist staff in the territory of the other Party, subject to the laws and regulations; and • Right to use the services and personnel of any other organisations
Non-scheduled services	<ul style="list-style-type: none"> • The Agreement applies to non-scheduled services, except for provisions regarding ATRs, capacity, and tariffs; and • The services are subject to the national laws and regulations of the Parties including in terms of market access 	<ul style="list-style-type: none"> • Non-scheduled services are allowed on routes not served by scheduled services; • Non-scheduled services by designated airlines are accorded the same rights as scheduled services; or • Non-scheduled services are allowed, subject to compliance with the laws and regulations of the country of origin 	<ul style="list-style-type: none"> • Non-scheduled services by designated airlines are accorded the same rights and market access as scheduled services; • Non-scheduled services by other airlines will be favourably considered based on comity and reciprocity; and • The services are subject to the national laws and regulations of a Party
Consultation	Regular consultation	Consultation upon request	
Dispute settlement	If consultations and negotiation fail, the dispute shall be resolved by diplomatic channels or arbitration	If consultations and negotiation fail, the dispute may be referred to mediation or a panel for settlement. If mediation fails, the dispute may be referred to arbitration	

Elements	Traditional	Transitional	Full Liberalisation
CRS	<ul style="list-style-type: none"> Application of the ICAO Code of Conduct for the Regulation and Operation of CRS, consistent with any other applicable regulations and obligations; or Agree on principles to govern and regulate CRS 		
Others	Application of national laws and regulations, customs duties, and taxes		
	Rights relating to the sale and marketing of air services products		
	Obligations and procedures relating to user charges		
	Obligations relating to currency conversion and remittance of earnings		
	Obligations relating to environmental protection		
	Provisions relating to entry into force, registration, amendment, and termination of the Agreement		
	Application of multilateral agreement		

Source: ICAO Template ASA

Sections 2 and 3 of this Paper further discuss the different approaches relating to the ATRs and the airline nationality requirement in the ICAO Template ASA and their application by States.

Malaysia’s ASAs

To date, Malaysia has entered into 106 bilateral ASAs²⁴.

Initially, Malaysia had entered into ASAs with countries in Europe and Asia. This was followed by ASAs with countries in the African and South American regions, consistent with Malaysia’s involvement in the Non-Aligned Movement and the South-South Cooperation network. More recently, Malaysia had entered into ASAs with Belize (2017), Bahamas (2016), Guyana (2016), Jamaica (2016), and Serbia (2015). In addition, Malaysia had also recently reviewed or amended its existing ASAs including those with Seychelles (2017), Turkey (2017), Nepal (2015), and Morocco (2015).

In addition, Malaysia has also entered into regional ASAs. As an ASEAN Member State, Malaysia is a party to various ASEAN ASAs that govern commercial civil aviation intra-ASEAN, as well as, between ASEAN and its Dialogue Partners (further discussed in Section 3). At present, ASEAN is negotiating a Comprehensive Air Traffic Agreement with the EU, which will be the first of such bloc-to-bloc arrangement.

As mentioned above, Malaysia has adopted its own template ASA in 2010 based on the ICAO Template ASA. The Malaysian template ASA is a guidance to its negotiators in negotiating ASAs with other States. Interestingly, it contains a variety of traditional, transitional, and full liberalisation provisions, reflecting the policies, interests, and level of liberalisation of Malaysia as regards the different aspects of an ASA. For example, provisions relating to authorisation and dispute settlement reflect the traditional approach, while provisions relating to designation, capacity, and change of gauge reflect the full liberalisation approach.

²⁴ Malaysia had negotiated for ASAs with Turkmenistan, Macedonia, and Paraguay, respectively, but no agreement was concluded.

Ultimately, the provisions in an ASA will reflect the outcome of the overall negotiation between the Parties. Malaysia may accept a more traditional or liberal approach in an ASA, departing from the position provided in its template ASA, depending on the level of development of the other State and the interests of the Parties. For example, the Malaysia-UK ASA (2013) allows the UK to designate carriers that are owned and controlled by EU Member States or their nationals to provide for the EU community carrier requirement. On the other hand, the Malaysia-Belize ASA (2017) is largely similar to the Malaysian ASA Template.

SECTION 2: ATRs UNDER ASAs

This section describes the different approaches regarding ATRs and capacity under ASAs, including those entered into by Malaysia bilaterally and regionally. It also discusses the effects of liberalisation of ATRs.

Freedoms of the Air

ATRs are exchanged between States based on specific “freedoms of the air” to provide clarity on the types of air services allowed under each ASA. Table 3 explains the different freedoms of the air in relation to scheduled air services.

Table 3: Freedoms of the Air

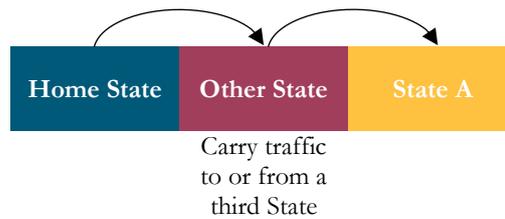
Freedom of the Air	Illustration
<p>The first freedom of the air: the right granted by State A to another State to fly across State A’s territory without landing</p>	<p>Overfly</p>
<p>The second freedom of the air: the right granted by State A to another State to land in State A’s territory for non-traffic purposes (such as maintenance or refuel) on the way to another State</p>	<p>Technical stop</p>
<p>The third freedom of the air: the right granted by State A to another State to carry traffic from that State to State A</p> <p><i>Illustration: a Malaysian carrier flying from Malaysia to Singapore and disembarking its passengers in Singapore</i></p>	<p>Disembark traffic</p>
<p>The fourth freedom of the air: the right granted by State A to another State to pick up traffic from the territory of State A destined for the home State of the carrier</p> <p><i>Illustration: A Malaysian carrier flying passengers from Singapore to Malaysia</i></p>	<p>Pick up traffic</p>

Freedom of the Air

Illustration

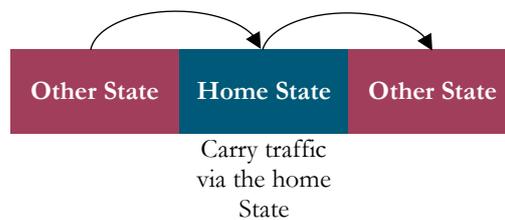
The fifth freedom of the air: the right granted by State A to another State to put down and to take on traffic in the territory of State A, coming from or destined to a third State

Illustration: A Malaysian carrier operating flights from Kuala Lumpur to Hawaii with a stop in Osaka. The fifth freedom allows the Malaysian carrier to transport passengers between Osaka and Hawaii, which means that passengers can book for the Osaka-Hawaii sector without starting the journey from Kuala Lumpur



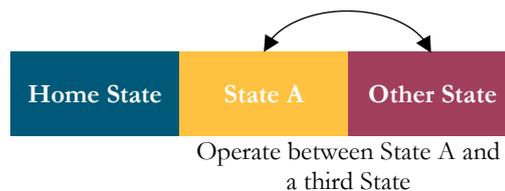
Sixth freedom of the air: the right of transporting traffic moving between two other States via the home State of the carrier

Illustration (hypothetical): A Malaysian carrier carrying passengers between Indonesia and the Netherlands via Malaysia



The seventh freedom of the air: the right granted by State A to another State to transport traffic between the territory of State A and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e. the service need not connect to or be an extension of any service to/from the home State of the carrier

Illustration (hypothetical): A Malaysian carrier operating flights between India and the UAE with no incoming/ongoing service from/to Malaysia

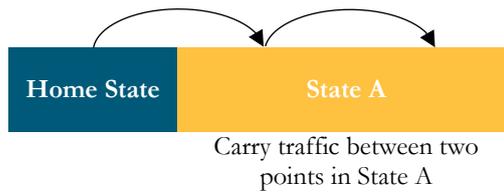


Freedom of the Air

Illustration

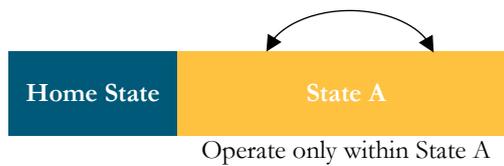
The eighth freedom of the air: the right granted by State A to another State to transport cabotage traffic between two points in the territory of State A on a service which originates or terminates in the home State of the foreign carrier or outside the territory of State A

Illustration (hypothetical): A Malaysian airline operating between Melbourne and Sydney, both in Australia, and the flight starts in Kuala Lumpur or any other place outside of Australia



The ninth freedom of the air: the right or privilege of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State

Illustration (hypothetical): A Malaysian carrier serving domestic flights within the UK



Source: ICAO

ICAO Template ASA Provisions Regarding ATRs and Capacity

Provisions regarding the grant of ATRs are provided in Article 3 of the ICAO Template ASA, which should be read together with an annexed schedule that sets out the applicable routes and any other condition attached to the exercise of the ATRs. For the purpose of this paper, the ATRs granted under an ASA are examined together with the rights granted with regard to capacity of services, which are closely interlinked.

The ICAO Template ASA acknowledges that ASAs would typically provide for the first freedom and second freedom rights to any airlines of a Party to the ASA²⁵.

In addition to the first and second freedom rights, the ICAO Template ASA provides the following general approaches in terms of ATRs and capacity:

- **The “traditional” approach:** the designated airlines are granted rights to make stops on routes specified in the route schedule attached to the ASA for the purpose of taking on board and discharging international traffic²⁶. The route schedule may specify the routes by naming the cities that may be operated by the designated airlines, including the cities in each Party and the intermediate and/or beyond points in a third country. It may cover the third, fourth, and fifth freedom rights. The exercise of the rights granted are limited by a predetermined capacity agreed by the Parties²⁷.
- **The “transitional” approach:** there are several options in terms of the ATR formulation under this approach, the elements of which are reflected in Table 4. In general, air services can be provided on a route that connects any city of one Party to any city of the other Party, and beyond to any city in a third country. This approach may provide up to the seventh freedom right and limited cabotage²⁸.

In terms of capacity, the transitional approach provides that airlines may offer capacity based on the Bermuda I principle where airlines determine capacity individually, based on qualitative criteria and subject to *ex post* review by the Parties. Alternatively, Parties may also agree to partially liberalise by not regulating capacity on certain routes and/or to increase the regulated capacity in the future based on a formula or schedule.

²⁵ The first and second freedom rights are often provided in an ASA despite their inclusion in the International Air Services Transit Agreement for scheduled international services because some States may not be parties to that agreement. However, we note, that 133 States have become parties to the International Air Service Transit Agreement, including Malaysia.

https://www.icao.int/secretariat/legal/List%20of%20Parties/Transit_EN.pdf, accessed on 1 September 2018.

²⁶ This may include passenger, mail and/or cargo traffic, subject to the negotiation between the Parties. However, for the purpose of this paper, the analyses are limited to scheduled passenger services.

²⁷ The traditional approach under Article 16 of the ICAO Template ASA.

²⁸ An example of limited cabotage is the co-terminal right, which refers to the right of a designated airline to serve two or more points in another Party on the same route and shall only be available as part of an international journey. The co-terminal right does not allow a designated airline of a Party to pick up and discharge passengers only for the domestic segment in the territory of the other Party. Another example of limited cabotage is where cabotage is allowed for a limited percentage of local traffic from the total passenger load.

- **The “full liberalisation” approach:** this approach opens all international and domestic markets of the Parties. Capacity-wise, the designated airlines shall have the freedom to determine their capacity, subject to competition law.

Table 4 summarises the ATRs and capacity elements reflected in the ICAO Template ASA based on the traditional, transitional, and full liberalisation approaches.

Table 4: Approaches under the ICAO Template ASA in Relation to ATRs and Capacity

Elements	Traditional	Transitional	Full Liberalisation
Specific city	✓		
Any city		✓	✓
Third and fourth freedoms	✓	✓ ²⁹	✓
Fifth freedom	✓ ³⁰	✓	✓
Sixth freedom		✓ ³¹	✓
Seventh freedom		✓ ³²	✓
Eighth freedom			✓
Ninth freedom			✓
Capacity			
- <i>Predetermined</i>	✓		
- <i>Partial liberalisation and/or predetermined increases</i>		✓	
- <i>Free determination</i>			✓

Source: ICAO Template ASA

The three approaches under the ICAO Template ASA reflect the general formulations regarding ATRs and capacity adopted by States. In reality, the provisions regarding ATRs and capacity under each ASA are customised by the States based on their policies and the overall outcome of the negotiations.

²⁹ Option 1 of the transitional approach in Annex 1 (Route Schedule) of the ICAO Template ASA.

³⁰ The traditional approach may cover up to the fifth freedom right. Annex 1 (Route Schedule) of the ICAO Template ASA.

³¹ Option 2 of the transitional approach in Annex 1 (Route Schedule) of the ICAO Template ASA.

³² Option 3 of the transitional approach in Annex 1 (Route Schedule) of the ICAO Template ASA.

In addition to those described in the traditional, transitional, and full liberalisation approaches under the ICAO Template ASA, the capacity provisions in ASAs may also contain the following elements:

- **Principles relating to third countries:** this refers to the general principles governing capacity for traffic destined for or coming from third countries on the routes specified in the ASA.
- **Capacity formula relating to third countries:** this provides a formula to control capacity for traffic to or from third countries on the routes specified in the ASA.
- **Excluding unilateral control:** this concerns a statement of principle that expressly excludes unilateral capacity control by a State. This usually appears in combination with the free determination or Bermuda I clause.
- **Cooperation on capacity:** this refers to a provision requiring or permitting commercial cooperation on matters which could affect capacity.
- **Filing requirement:** this refers to provisions requiring the airlines to file their flight schedules and/or capacity for the purpose of government approval or notification.
- **Non-scheduled operations:** this refers to provisions governing non-scheduled operations.
- **All-cargo operations:** this refers to a separate capacity provision for scheduled all-cargo services.
- **Change of gauge:** this refers to the right to change to a different type of aircraft at a point along the route outside the home State for operational purposes.
- **Capacity transfer:** this concerns a provision that allows for the transfer of capacity by one Party, that is unable or unwilling to exercise certain operating rights under the ASA in terms of capacity, to the other Party.

The number of bilateral ASAs containing the different ATRs and capacity formulations are detailed in Table 5.

Table 5: Number of ASAs Based on ATRs and Capacity Formulations, 2017

Criteria	No. of ASAs	Criteria	No. of ASAs
ATRs		Capacity elements	
- <i>Third and fourth freedoms</i>	2,841	- <i>Capacity principle</i>	2,464
- <i>Fifth freedom</i>	1,822	- <i>Capacity control</i>	326
- <i>Sixth freedom</i>	160	- <i>Third countries principle</i>	1,525
- <i>Seventh freedom</i>	126	- <i>Third countries formula</i>	152
- <i>Eighth freedom</i>	-	- <i>Excluding unilateral</i>	361
- <i>Ninth freedom</i>	12	- <i>Cooperation</i>	481
Capacity		- <i>Filing requirement</i>	1,660
- <i>Predetermined (traditional)</i>	1,833	- <i>Non-scheduled</i>	66
- <i>Bermuda I (transitional)</i>	462	- <i>Scheduled all-cargo</i>	53
- <i>Free determination (full liberalisation)</i>	323	- <i>Change of gauge</i>	495
- <i>Other</i>	176	- <i>Transfer</i>	237

Source: ICAO WASA

ATRs under Malaysia's ASAs

As mentioned above, Malaysia has entered into 106 bilateral ASAs. The paragraphs below explain the extent of ATRs contained in such ASAs and the utilisation of the ATRs.

Overview of the ATRs under Malaysia's ASAs

A summary breakdown of the bilateral ASAs entered into by Malaysia in terms of ATRs is provided in Table 6. For the purpose of this analysis, a right is considered as limited if the exercise of such right is limited in terms of routes or capacity.

Table 6: Number of ASAs Entered into by Malaysia Based on the Type and Level of ATRs Exchanged, 2018

ATRs	No. of ASAs	
	Limited	Unlimited
Third and fourth freedoms	55	51
Fifth freedom	67	21
Sixth freedom	0	2
Eighth/ninth freedom	0	1

Source: MAVCOM Analysis

All bilateral ASAs entered into by Malaysia provide for the third and fourth ATRs. In addition, a majority of Malaysia's ASAs also contain the fifth freedom right—although, the number of ASAs with limited fifth freedom right is approximately triple of the ASAs with unlimited fifth freedom rights.

An example of an ASA with limited ATRs is the Malaysia-Turkey ASA. It provides Malaysian-designated airlines with rights to operate unlimited third and fourth freedoms between any point in Malaysia and Turkey and two other specified points in Turkey³³. However, Malaysian LCCs are only allowed to operate into Istanbul Sabiha Gokcen Airport³⁴. In addition, the fifth freedom operations under the Malaysia-Turkey ASA are limited in frequency (14 flights weekly) and points (to be agreed by the Parties).

In comparison, the Malaysia-Qatar ASA allows the designated airlines to operate between any points in Malaysia and Qatar, through and beyond any point in a third country, with no limitation in terms of frequency or capacity³⁵.

³³ Memorandum of Understanding between Government of Malaysia and the Government of the Republic of Turkey (2017).

³⁴ Memorandum of Understanding between Government of Malaysia and the Government of the Republic of Turkey (2011).

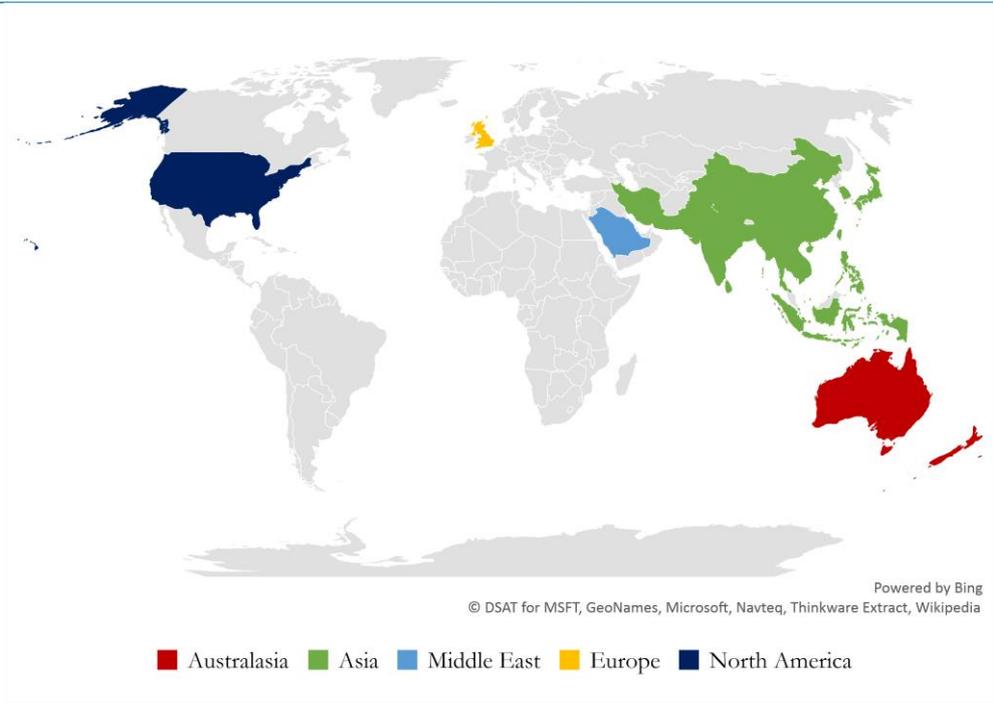
³⁵ Agreement between the Government of Malaysia and the Government of the State of Qatar for Air Services Between and Beyond Their Respective Territories; Memorandum of Understanding between the Government of Malaysia and the Government of the State of Qatar (14 May 2011).

Meanwhile, the Malaysia-UK ASA is the most liberal ASA entered into by Malaysia³⁶. The agreement grants up to the ninth freedom right to the designated airlines with no restriction in terms of routes, frequency, and capacity³⁷.

Utilisation of Malaysia’s ASAs

Despite the large number of ASAs entered into by Malaysia, the overall rate of utilisation of such ASAs is considerably low. Out of the 106 ASAs entered into by Malaysia, Malaysian carriers currently utilise the third and fourth freedom rights to fly directly to 25 countries (see Figure 1). The direct flights by Malaysian carriers are mainly concentrated on routes connecting to ASEAN countries, China, India, and Australia.

Figure 1: Direct Connections Provided by Malaysian Carriers



Source: MAVCOM Analysis

³⁶ The Malaysia-UK ASA would not be directly affected by the UK’s impending exit from the EU, commonly known as “Brexit”. Only ASAs that were entered into by a State with the EU will be affected by Brexit. For example, the US had entered into an ASA with the UK in 1997, which was replaced by the EU-US ASA from 2008 onwards to govern international air transport between the US and EU Member States, including the UK. The EU-US ASA will not be applicable to the UK post-Brexit. Thus, the UK and the US will need to enter into a new ASA to govern their future bilateral air transport services. It was reported that talks between the UK and the US on post-Brexit air services arrangements had commenced (Boccardo and Knight, 2018).

³⁷ Memorandum of Understanding between the Aeronautical Authorities of the United Kingdom of Great Britain and Northern Ireland and Malaysia (2013).

The generally low utilisation of ATRs by Malaysian carriers might be due to several factors:

- There might be a mismatch between the market access and supply/demand for air services between the respective Parties to the ASAs. Malaysia might have entered into ASAs with certain countries to pursue general diplomatic relations objectives, rather than to address specific industry or passenger needs for air connectivity to those countries. As shown later in this Section, the impact of an ASA on passenger flow depends on other factors such as close economic activities between the States. The presence of an ASA per se would not guarantee increased air services between the Parties.
- The utilisation of Malaysia's ATRs would depend on the presence of local airlines with strong and extensive networks. In this regard, Malaysia Airlines had undergone huge route rationalisation exercises involving its international services as part of its business restructuring plans. These rationalisation exercises had reduced its network significantly compared to its highest number of direct connections to 44 countries in April 2000³⁸. Meanwhile, other Malaysian carriers are mainly focused on serving Asian Pacific destinations at present, with the exception of AirAsia X, which provides services to Hawaii³⁹.

With regard to the utilisation of ATRs under ASAs with limited capacity, Malaysian carriers are utilising 100% of the capacity for the Malaysia-Nepal and Malaysia-Pakistan routes, which are mainly used for the transportation of foreign workers. In addition, the seven per week frequencies to Tokyo Haneda International Airport under the Malaysia-Japan ASA are also fully-utilised by Malaysian carriers. Malaysian carriers are also utilising more than 90% of the limited ATRs to Australia and India.

On the other hand, the utilisation of ATRs by foreign carriers does not necessarily mirror that of Malaysian carriers. For example, foreign carriers from Bangladesh, Nepal, and Pakistan only utilise between 21% and 50% of their restricted ATRs under the respective ASAs with Malaysia, and the Australian carriers do not utilise their limited ATRs at all. Exceptions are the carriers from Japan and Saudi Arabia, which currently utilise 100% of their ATRs. We further note that carriers from countries with unrestricted ASAs such as Macao, New Zealand, and the US are not operating into Malaysia despite the existence of such liberal arrangements.

Therefore, there is a discrepancy in terms of the number of ASAs entered into by Malaysia and the ATR utilisation by Malaysian and foreign carriers under those ASAs. In light of the above, it is important for Malaysia to align its future strategies regarding the liberalisation of ATRs with the nation's connectivity, trade, and tourism objectives, taking into account relevant factors such as the development of the routes' supply and demand levels.

³⁸ Included connections to North America, South America, and Africa.

³⁹ Other than Malaysia Airlines and AirAsia X, the other Malaysian carriers (AirAsia, Firefly, and Malindo) only serve the Asian Pacific region.

ATRs Under ASEAN ASAs

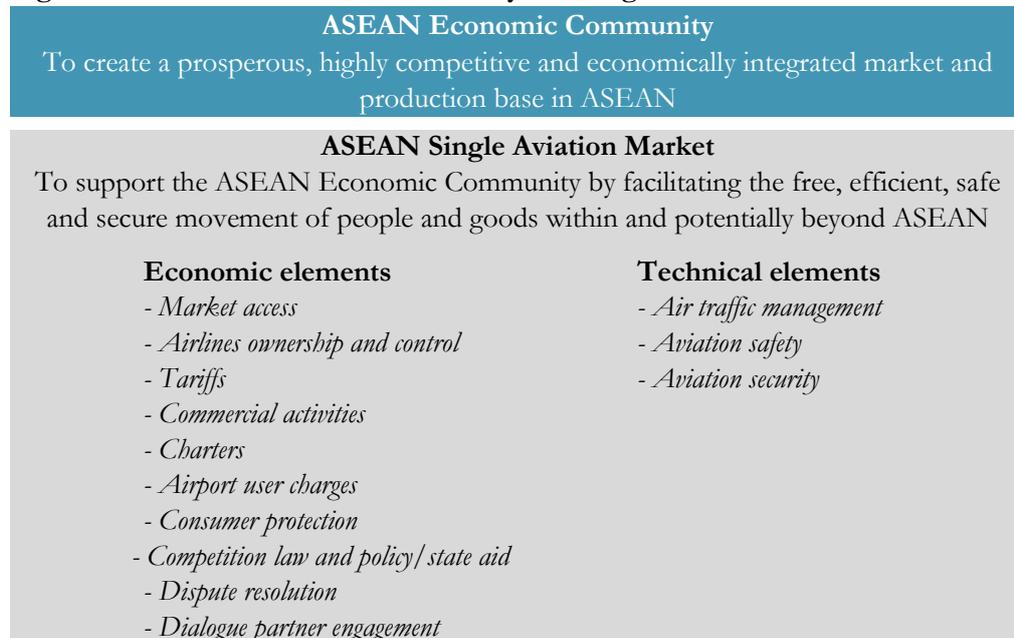
ASEAN is an intergovernmental organisation comprising ten Southeast Asian countries: Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Singapore, Thailand, the Philippines, and Vietnam. ASEAN has played an important role in the development of air services in the region.

ASEAN Single Aviation Market

The main driver of civil aviation liberalisation in ASEAN is the establishment of the ASEAN Single Aviation Market by 2015. The ASEAN Single Aviation Market is an initiative to support the ASEAN Economic Community by facilitating the free, efficient, safe, and secure movement of people and goods within and potentially beyond ASEAN.

The ASEAN Single Aviation Market covers both the economic and technical elements. Figure 2 provides details on subject matters falling within the scope of the ASEAN Single Aviation Market.

Figure 2: ASEAN Economic Community and Single Aviation Market Framework



Source: ASEAN

The ASEAN Single Aviation Market encompasses not only the intra-ASEAN markets, but also the markets between ASEAN and its Dialogue Partners⁴⁰. However, ASEAN's foremost priority is the intra-ASEAN integration through ASEAN ASAs and their protocols. ASEAN Member States have affirmed their commitments to ratify ASEAN ASAs or protocols before ratifying the corresponding ASAs between ASEAN and its Dialogue Partners⁴¹. In the event that an ASEAN Member State ratifies an ASA between ASEAN and its Dialogue Partner before ratifying the corresponding ASEAN ASA, such State is obligated to accord no less favourable ATRs to all other ASEAN Member States that have ratified the said ASEAN ASA⁴².

ATR under Intra-ASEAN ASAs

The implementation of the ASEAN Single Aviation Market is anchored by the following two main agreements and their protocols⁴³:

- MAAS
 - Protocol 1 on Unlimited Third and Fourth Freedom Rights Within ASEAN Sub-Region
 - Protocol 2 on Unlimited Fifth Freedom Right Within ASEAN Sub-Region
 - Protocol 3 on Unlimited Third and Fourth Freedom Rights between the ASEAN Sub-Regions
 - Protocol 4 on Unlimited Fifth Freedom Right between the ASEAN Sub-Regions
 - Protocol 5 on Unlimited Third and Fourth Freedom Rights between ASEAN Capital Cities
 - Protocol 6 on Unlimited Fifth Freedom Right between ASEAN Capital Cities

⁴⁰ ASEAN's Dialogue Partners are Australia, Canada, China, the EU, India, Japan, Republic of Korea, New Zealand, Russia, and the US.

⁴¹ Paragraph 2, Memorandum of Understanding on ASEAN's Air Services Engagement with Dialogue Partners (2010).

⁴² Paragraph 4, Memorandum of Understanding on ASEAN's Air Services Engagement with Dialogue Partners (2010).

⁴³ ASEAN has also entered into the Multilateral Agreement on the Full Liberalisation of Air Freight Services (MAFLAFS) that provides for market access for air freight services. This agreement is accompanied by two protocols: Protocol 1 on Unlimited Third, Fourth and Fifth Freedom Traffic Rights among Designated Points in ASEAN and Protocol 2 on Unlimited Third, Fourth and Fifth Freedom Traffic Rights among All Points with International Airports in ASEAN.

- MAFLPAS
 - Protocol 1 on Unlimited Third and Fourth Freedom Rights between Any ASEAN Cities
 - Protocol 2 on Unlimited Fifth Freedom Right between Any ASEAN Cities
 - Protocol 3 on Domestic Code-Share Rights Between Points within the Territory of Any Other ASEAN Member State

ASEAN adopts a phased approach towards liberalising its regional ATRs, adopting staggered deadlines for implementation of the agreements and protocols that entail different levels of liberalisation. However, despite the phased approach, the original target dates for the implementation of the agreements and protocols were largely not met, as illustrated below:

- The targeted implementation date for the MAAS and its Protocols 1 to 5 was 31 December 2008⁴⁴. However, the agreement and protocols were only adopted on 20 May 2009 and entered into force on 22 December 2009. The MAAS and its Protocols 1 to 5 were fully ratified by ASEAN Member States between 2011 and 2016⁴⁵.
- The MAFLPAS and its Protocol 1 were targeted for implementation by 30 June 2010⁴⁶. However, they were adopted only on 12 November 2010 and had entered into force on 30 June 2011, one year after the target date. The full ratification by all ASEAN Member States was achieved on 7 April 2016.

⁴⁴ ASEAN Single Aviation Market Implementation Framework (2011).

⁴⁵ The MAAS and its Protocols 1 and 2 were fully ratified by ASEAN Member States in November 2011, while its Protocols 3 and 4 were fully ratified on 29 November 2012. Protocols 5 and 6 reached full ratification on 11 March 2016.

⁴⁶ ASEAN Single Aviation Market Implementation Framework (2011).

Table 7 shows an overview of the ATRs granted under the MAAS, the MAFLPAS, and their respective protocols. We note that in addition to the third, fourth, and fifth freedom rights provided under MAAS and Protocols 1 and 2 of MAFLPAS, Protocol 3 of MAFLPAS provides for domestic code-share rights. This refers to the right to enter into code-share arrangements between a designated airline of one State (marketing airline) with an airline of another State (operating airline) for services between two points within the territory of the latter State⁴⁷. Such code-share rights must be exercised as part of an international journey⁴⁸. Examples are: the Myanmar Airways-Malaysia Airlines code-share arrangement for services between Kuala Lumpur and Penang as part of the journey from Yangon; and the Philippines Airlines code-share with Malaysia Airlines for services between Kuala Lumpur and Kota Bahru as part of the journey from Manila.

Table 7: ATRs under ASEAN ASAs and Protocols

ASEAN ASAs and Protocols	Third and Fourth Freedoms	Fifth Freedom	Domestic Code-Share	Routes
MAAS				
- Protocol 1	✓			Between designated cities within an ASEAN sub-region ⁴⁹
- Protocol 2		✓		
- Protocol 3	✓			Between designated cities in different ASEAN sub-regions
- Protocol 4		✓		
- Protocol 5	✓			Between ASEAN capital cities
- Protocol 6		✓		
MAFLPAS				
- Protocol 1	✓			Between any ASEAN cities
- Protocol 2		✓		
- Protocol 3			✓	Between points in any other ASEAN Member State

Source: ASEAN

⁴⁷ Article 2 of Protocol 3 on Domestic Code-Share Rights Between Points within the Territory of Any Other ASEAN Member State.

⁴⁸ Article 1 of Protocol 3 on Domestic Code-Share Rights Between Points within the Territory of Any Other ASEAN Member State.

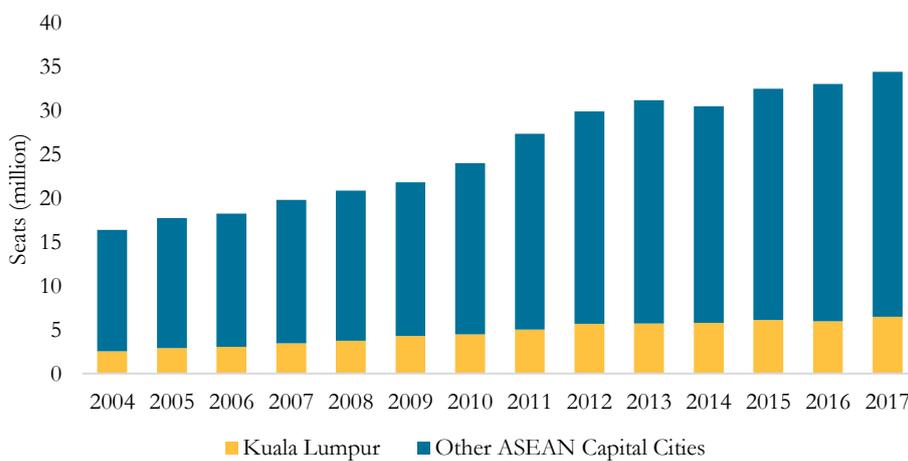
⁴⁹ At present, ASEAN sub-region comprises: the Brunei Darussalam, Indonesia, Malaysia, Philippines-East ASEAN Growth Area (BIMP-EAGA); the Sub-regional Cooperation in Air Transport among Cambodia, Lao PDR, Myanmar and Vietnam (CLMV); the Indonesia, Malaysia, Singapore-Growth Triangle (IMS-GT); and the Indonesia, Malaysia, Thailand-Growth Triangle (IMT-GT).

The MAAS and its Protocols 1 to 4 provide for somewhat modest market access within and between ASEAN sub-regions. The third, fourth, and fifth freedoms provided under the MAAS and its Protocols 1 to 4 are limited to the designated points, which are mostly secondary cities. In some cases, the number of designated points under Protocols 3 and 4 (for rights between sub-regions) is less than the number of designated points under Protocols 1 and 2 (for rights within sub-region). Examples are as follows:

- For the BIMP-EAGA sub-region, Malaysia designated Kota Kinabalu, Labuan, Kuching, and Miri under Protocols 1 and 2. However, for Protocols 3 and 4, only Labuan and Miri were designated while the larger cities of Kota Kinabalu and Kuching were excluded.
- Similarly, Indonesia designated Medan, Padang, Banda Aceh, and Nias for the IMT-GT sub-region under Protocols 1 and 2. On the other hand, it only designated Medan and Padang under Protocols 3 and 4 of the MAAS.

The third, fourth, and fifth freedom rights granted under Protocols 5 and 6 of the MAAS are also limited to ASEAN capital cities only. However, given the population and air passenger traffic of these primary cities, the impact of Protocols 5 and 6 of the MAAS would be considerable. Figure 3 shows the growth in overall seat capacity by ASEAN Member States’ airlines in connecting ASEAN capital cities from 2004 to 2017.

Figure 3: Seat Capacity by ASEAN-based Airlines for Routes Between ASEAN Capital Cities, 2004 – 2017



Source: MAVCOM Analysis, AirportIS

Figure 3 shows that the growth in seat capacity by ASEAN-based airlines prior to the entry into force of Protocols 5 and 6 of the MAAS (on 22 December 2009) was slower compared to the period thereafter. Between 2004 and 2009, the seat capacity increased by 3.7 million. However, the increase from 2010 – 2012 was larger with a total increase of 3.9 million (2010 – 2011: 2.8 million; 2011 – 2012: 2.1 million). In 2017, the number of seats provided by ASEAN airlines for routes between ASEAN capital cities reached 28.0 million, more than double the seat capacity in 2004. Given that Protocols 5 and 6 of the MAAS were only fully ratified by ASEAN Member States in 2016, the full impact of these Protocols is yet to be seen.

Additionally, ASEAN Member States are reviewing the ATRs provided under the existing agreements and protocols for the purpose of further liberalisation. At present, ASEAN Member States are negotiating and drafting a new Protocol 4 under the MAFLPAS regarding co-terminal rights.

ATRs under ASAs between ASEAN and Its Dialogue Partners

The first ASA between ASEAN and its Dialogue Partner is the ASEAN-China ASA, which was entered into in 2010 (further details below).

In addition to China, ASEAN is also negotiating or seeking to negotiate ASAs with other Dialogue Partners such as India, Japan, the EU, the Republic of Korea, and New Zealand. According to the ASEAN Transport Strategic Plan for 2016 – 2025, ASEAN aims to conclude ASAs with India, Japan, the EU, and Republic of Korea by the year 2020. ASEAN aims to conclude ASAs with its other Dialogue Partners by 2025.

ASEAN-China ASA

The ASEAN-China ASA is accompanied by the following two Protocols:

- Protocol 1 on Unlimited Third and Fourth Freedom Rights Between Any Points in Contracting Parties that had entered into force on 9 August 2011⁵⁰
- Protocol 2 on Fifth Freedom Right Between Contracting Parties that had entered into force on 8 September 2015⁵¹

ASEAN and China are currently negotiating for Protocol 3 of the ASEAN-China ASA to provide for further expansion of the fifth freedom right.

⁵⁰ ICAO's letter to ASEAN dated 22 March 2018.

⁵¹ ICAO's letter to ASEAN dated 22 March 2018.

The ATRs granted under Protocols 1 and 2 of the ASEAN-China ASA are summarised in Table 8.

Table 8: ATRs under the ASEAN-China ASA and Protocols

Protocol	Freedom	From	Routes		Beyond
			Via	To	
Protocol 1					
- <i>Unlimited frequency for ASEAN</i>	Third and fourth	Any point in ASEAN	-	Any point in China	-
- <i>Unlimited frequency for China</i>	Third and fourth	Any point in China	-	Any point in ASEAN	-
Protocol 2					
- <i>Unlimited frequency for ASEAN</i>	Fifth	One of the ten named points in ASEAN ⁵²	Any of the ten named points in ASEAN	Any of the 28 named points in China ⁵³	Any of the ten named points in ASEAN
- <i>Unlimited frequency for China</i>	Fifth	One of the 28 named points in China	Any of the ten named points in ASEAN	Any of the ten named points in ASEAN	Any of the ten named points in ASEAN
- <i>14 weekly frequency for ASEAN</i>	Fifth	One of the ten named points in ASEAN	Any point outside China and ASEAN	Any of the ten named points in China ⁵⁴	Any point outside China and ASEAN
- <i>14 weekly frequency for China</i>	Fifth	Any of the ten named points in China	Any point outside China and ASEAN	Any of the ten named points in ASEAN	Any point outside China and ASEAN

Source: ASEAN

The ASEAN-China ASA is often criticised for providing unbalanced market access to Chinese carriers in comparison with ASEAN-based carriers. For example, under Protocol 1 of the ASEAN-China ASA, an airline of an ASEAN Member State can only operate from the points in its home State to China, while a Chinese carrier can fly from China to any point in any ASEAN Member States. Due to the nature of ASEAN as an intergovernmental organisation, the ATRs provided under the ASEAN-China ASA are attached to each ASEAN Member State individually, and not ASEAN collectively as a single unit.

⁵² Within the territory of the designating State.

⁵³ The 28 named points in China are: Changchun; Changsha; Chengdu; Chongqing; Dalian; Fuzhou; Guilin; Guiyang; Haikou; Harbin; Hohhot; Kashgar; Kunming; Lanzhou; Lhasa; Sanya; Shenyang; Nanning; Ningbo; Urumqi; Wuhan; Xi'an; Xiamen; Xining; Xishuangbanna; Yanji; Yinchuan; and Zhengzhou.

⁵⁴ The ten named points in China are: Changsha; Chengdu; Chongqing; Guilin; Kunming; Nanning; Urumqi; Xi'an; Xiamen or Fuzhou; and Zhengzhou.

In comparison, the EU, which is a supranational organisation, negotiates and enters into ASAs with another State as a single Party comprising 28 Member States, following the establishment of the European Internal Aviation Market (further explained below). Also, the EU negotiates for the recognition of the EU community carrier with its ASA partners. As a result, any EU community carrier would be able to exercise the ATRs under the ASA from any point in the EU, not just from the home State of the airline. For example, under the EU-US ASA, an EU airline based in the Netherlands may exercise the third and fourth freedom rights to operate air services between Paris and New York.

Lenoir and Laplace (2016) studied how the ASEAN-China market had developed between 2006 and 2015. They found that the Chinese airlines benefited more from the growth in the ASEAN-China market in terms of capacity, routes, and network development. This is especially true for the markets between China and the six ASEAN Member States that first ratified Protocol 1 of the ASEAN-China ASA⁵⁵. Table 9 shows the changes in terms of market shares, number of airlines, and number of routes between the Chinese and ASEAN carriers in 2006 and 2015.

Table 9: Market Share, Number of Airlines, and Number of Routes between ASEAN-China Routes, 2006 – 2015

ASEAN-China Routes	Chinese Carriers		ASEAN Carriers	
	2006	2015	2006	2015
Market share (seats)	35%	51%	59%	48%
Number of airlines	8	15	17	27
Number of routes ⁵⁶	About 100	More than 370	About 100	About 250

Source: Lenoir and Laplace (2016)

In relation to network development, Lenoir and Laplace (2016) also found that in 2015, 52% of the routes were solely operated by the Chinese carriers, compared to 27% of routes being operated solely by the ASEAN carriers. The other 21% of the routes were operated by both the Chinese and ASEAN carriers. It was concluded that these figures indicate the dominance of the Chinese carriers in the ASEAN-China networks.

As a whole, the ASEAN-China market continues to grow, reaching 33.5 million passengers in 2017. In the 2018 Summer Season, there were 29 Chinese airlines operating routes connecting 49 Chinese cities to 35 ASEAN cities, and 40 airlines from ASEAN operating routes connecting 34 ASEAN cities to 47 Chinese cities⁵⁷. The total number of flight frequencies operated by China and ASEAN had increased from 820 frequencies per week during the 2010 Summer Season to 3,922 frequencies per week during the 2018 Summer Season⁵⁸.

⁵⁵ The six ASEAN Member States are Brunei, Malaysia, Myanmar, Singapore, Thailand, and Vietnam.

⁵⁶ Routes that were operated by several carriers were counted separately. Thus, the total number of routes in the study exceeded the actual number for distinct routes due to the overlapping services.

⁵⁷ ASEAN-China Working Group.

⁵⁸ ASEAN-China Working Group.

To avoid similar market access issues in the future operation of ASAs between ASEAN and its Dialogue Partners, it has been suggested for ASEAN to unify its fragmented internal markets and adopt designation based on an ASEAN community carrier principle (further explained in Section 3) towards achieving a truly ASEAN Single Aviation Market⁵⁹. Should ASEAN adopt such approach, ASEAN would need to pursue negotiations with its Dialogue Partners for the recognition of such ASEAN community carrier designation. However, such an effort would need to be driven by strong political will by its Member States as the process could be expected to be complicated and long, considering the nature of ASEAN as an inter-governmental organisation that works on the basis of consensus.

Effects of Liberalisation of ATRs

In line with Articles 6 and 7 of the Chicago Convention, most States would pursue more liberal ATRs through bilateral ASAs with other States. However, there are some instances where States would also pursue a liberal policy regionally (such as the creation of the European Internal Aviation Market) or unilaterally (such as Chile's unilateral opening of cabotage rights to foreign airlines). The following paragraphs analyse the effects of the liberalisation of ATRs and capacity both in general and in specific cases.

The Liberalisation of ATRs and Capacity Would Increase Competition in General

In general, the liberalisation of ATRs has brought significant traffic growth⁶⁰. Liberalisation removes constraints on the exercise of ATRs by airlines (in terms of route, capacity, pricing, and cooperative arrangements between airlines). This allows airlines to compete more effectively and improve efficiency, which would lead to reduced airfares, increased frequencies, and improved service quality.

Furthermore, liberalisation enables airlines to: restructure and optimise their flight networks to meet demand; improve cost efficiency by exploiting the economies of traffic density⁶¹; enhance service quality by providing direct flights or increasing capacity; or compete more aggressively in terms of pricing. One of the most common outcomes of liberalisation is the emergence of the hub-and-spoke network. While the hub-and-spoke model may increase travel time, it also increases flight frequency and city-pairs served by airlines⁶².

⁵⁹ Tan (2013).

⁶⁰ Fu, Oum, and Zhang (2010).

⁶¹ Traffic density is calculated by dividing the total traffic volume by the carrier's network size.

⁶² Fu, Oum, and Zhang (2010).

Piermartini and Rousova (2013) studied approximately 2,300 ASAs on the effects of the liberalisation of international ASAs on bilateral passenger flows⁶³. They found that free pricing and free determination of capacity, combined with the community of interest ownership regime, would have the largest impact on passenger flows. The study also estimated the impact of a worldwide adoption of specific types of provisions. It was predicted that air traffic would increase by —

- 0.5% if all existing agreements provide for multiple designation;
- 5% if all existing agreements provide for free determination of capacity;
- 9% if all existing agreements provide for free pricing and the establishment of community of interest; and
- 11% if all existing agreements provide for cabotage rights.

Nevertheless, in reality, the effects of the liberalisation of ATRs and capacity may vary from one market to another due to many factors. In the case of a bilateral liberalisation of ATRs via an ASA, its impact would ultimately depend on the profiles of the Parties to the ASA (including population, economic growth, and income level) and the bilateral relations between the Parties in term of history, culture, trade, and tourism. This is due to the linkages between air transport and the overall economy of the Parties, where the demand for air transport services is a derived demand, purchased as inputs for the consumption and production of other services. In simple terms, passengers need a reason to travel by air, be it for business or leisure. In this regard, Boeing (2008) attributed about two-thirds of traffic growth to the GDP growth⁶⁴, while the remaining one-third was attributed to other factors such as increasing trade, lower costs, and improved services.

⁶³ The research focused on passenger traffic instead of airfares to account for the possibility that liberalisation affects airfares as well as the quality of air transport, which could be seen from the passenger traffic.

⁶⁴ A 1% increase in GDP would lead to a 1.27% increase in air travel (Boeing, 2008).

Also relevant is the study by Zhang and Findlay (2014) that investigated the impact of air transport policy⁶⁵ on passenger traffic and tourist flows. The study concluded that liberalisation is significantly and positively associated with the movement of people. Other observations made in the study include the following:

- The higher restrictions of aviation policy would lead to a lower level of movement of persons between international cities. This shows the importance of aviation policy and its influence on passenger traffic.
- Higher GDP in either the destination or departure economy would be associated with higher volume of passenger and tourist flows.
- A common language was found to be an important factor that facilitates bilateral tourist flow. It also plays a role in increasing passenger traffic between city-pairs.

Compared to the liberalisation of ATRs at the domestic, regional or bilateral levels, the commercial value of unilateral provision of cabotage rights remains a contentious matter. Only a small number of domestic markets in the world are lucrative enough to entice the entry of foreign airlines. Moreover, it is argued that even if a State with large domestic markets would allow foreign airlines to provide cabotage services, a lack of brand presence might make the foreign airlines unappealing to consumers⁶⁶.

The effects of liberalisation of markets at the regional, bilateral, and domestic levels are further illustrated by the following case studies.

Case study: The regional air traffic liberalisation through the European Internal Aviation Market

The European Internal Market for Aviation was initiated in 1992 to replace the national rules of the EU Member States with a single set of EU rules, creating a single internal market. Prior to that, the air transport market across Europe was a collection of national markets. Domestic air services within each country were governed by national laws, and international air transport in Europe was governed by bilateral ASAs between the EU Member States. Those national laws and ASAs varied from one another, with different restrictions in terms of market access, route, capacity, and airline ownership.

The EU liberalised its regional market in phases through three packages of liberalisation. The third package of liberalisation entailed the creation of the EU community carrier and the common licensing criteria for airlines across the region, amongst others. This allowed EU-based airlines to exercise unfettered ATRs on any route within the EU.

⁶⁵ Including ownership requirement, foreign equity participation in domestic airlines, multiple designation of airlines on international routes, the existence of LCC (reflecting the ease of market access and fair competition), the number of airlines (reflecting ease of market entry), the existence of open skies agreement, and seventh freedom rights for cargo.

⁶⁶ Havel and Sanchez (2014).

The European Internal Market for Aviation had led to the following effects⁶⁷:

- Lower airfares arising from the removal of barriers to competition (such as via the liberalisation of ATRs and the recognition of community carriers). For example, the minimum price for a flight ticket from Milan to Paris has dropped from more than EUR400 in 1992 to approximately EUR25 in 2017.
- The opening of national markets and the creation of an EU single aviation market increased competition in the industry, leading to an increase in intra-EU routes served by airlines. For example, the number of intra-EU routes connecting with the Dublin airport had increased from 36 in 1992 to 127 routes in 2017.

Another major development in the EU following its regional market liberalisation is the growth of LCCs. Dobruszkes (2009), in examining airline competition in the EU after the European Internal Aviation Market, found that the LCCs had benefited most from the liberalisation. In terms of the utilisation of the seventh and ninth freedom rights, LCCs made up 77% and 47% of the seat capacity in 2005, respectively⁶⁸. The development of LCCs also increased airlines rivalry in the European market.

Case study: The Australia-New Zealand bilateral liberalisation of air traffic

The liberalisation of the Australia and New Zealand bilateral air services market could be traced from the conclusion of the Single Aviation Market Agreement, which entered into effect in 1996. Amongst the key elements of the Single Aviation Market agreement were the opening of the airline ownership and control requirement for the bilateral market. This allowed a SAM airline⁶⁹ to operate unlimited frequencies between Australia and New Zealand, as well as cabotage services within either State. Examples of SAM airlines were Ansett Australia⁷⁰ and JetConnect⁷¹.

Subsequently, Australia and New Zealand entered into an ASA in 2002 that came into effect on 25 August 2003. In relation to ATRs, the Australia-New Zealand ASA provides the following:

- A SAM airline may operate any points in Australia and/or New Zealand, which covers the third, fourth, and ninth freedom rights (cabotage).
- Airlines designated by a Party⁷² are granted unrestricted ATRs, including connections to any points behind, intermediate or beyond Australia or New Zealand, as the case may be.
- The provision of services agreed under the ASA is unrestricted in terms of routes and capacity.

⁶⁷ European Commission (2017).

⁶⁸ Dobruszkes (2009).

⁶⁹ An airline that is at least 50% owned and effectively controlled by either Australian or New Zealand nationals or both, with its head office and operational base in Australia or New Zealand.

⁷⁰ Ansett Australia was an airline established in Australia that was wholly-owned by Air New Zealand.

⁷¹ JetConnect was an airline established in New Zealand that was wholly-owned by Qantas.

⁷² A designated airline refers to an airline that is: incorporated and has its principal place of business in the territory of the Party designating the airline; and effectively controlled by the designating Party or its nationals or both. A designated airline shall also fulfil other requirements provided under Article 2(2) of the Australia – New Zealand ASA.

InterVISTAS carried out a study on the effect of the liberalisation of the Australia-New Zealand aviation market in terms of capacity and traffic between 1994, 2001, and 2012⁷³. It concluded that the liberalised agreements had established a competitive environment for the Australian and New Zealand carriers in the bilateral market. The liberalisation had also resulted in the fragmentation of the market by the expansion of services to new destinations. The number of direct services between Australia and New Zealand had increased from 12 in 1995 to 23 in 2012 (see Table 10).

Table 10: New Services and Connections in the Australia-New Zealand Market

Year	Number of Direct Australia-New Zealand Services	Emergence of New Connection in Australia or New Zealand
1995	12	-
2001	13	Queenstown Adelaide Dunedin
2012	23	Gold Coast Hamilton Rotorua Sunshine Coast

Source: InterVISTAS

It was also found that the Australia-New Zealand liberal agreements had contributed to the growth in passenger traffic between the two countries as a whole. The growth in passenger traffic in non-major markets was even more obvious. Table 11 shows the growth in passenger traffic between Australia and New Zealand in general, as well as between their major and non-major markets.

Table 11: Growth in Passenger Traffic Between Australia and New Zealand, 1994 – 2012

Year	CAGR Growth in Total Passengers Between Australia and New Zealand (%)		
	Total	Major Markets ⁷⁴	Non-Major Markets ⁷⁵
1994 – 1996	8.2	6.4	63.7
1996 – 2002	5.3	4.1	19.7
2002 – 2012	4.9	4.8	5.6

Source: InterVISTAS

In addition, the study found that the total O&D passengers in the Australia-New Zealand market grew by almost 15% between 2005 and 2012⁷⁶, while the number of annual departures and capacity grew by approximately 5% between the same period⁷⁷.

⁷³ InterVISTAS Consulting Inc. (2015).

⁷⁴ Major markets refer to all routings between the main locations in Australia (Adelaide, Brisbane, Melbourne, Perth, and Sydney) and New Zealand (Auckland, Christchurch, and Wellington).

⁷⁵ Non-major markets refer to all markets between Australia and New Zealand that are not major markets. They include connections between main locations in Australia or New Zealand with a secondary point.

⁷⁶ In terms of the O&D passengers, the passenger traffic increased from approximately 3.9 million in 2005 to about 4.5 million in 2012.

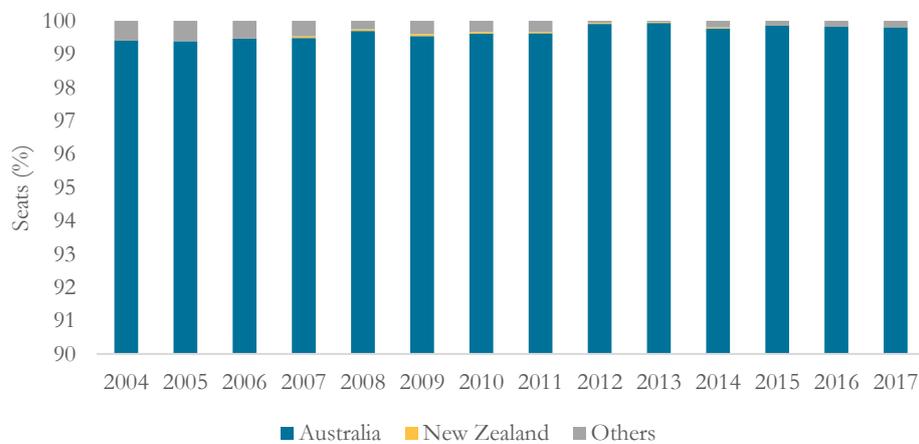
⁷⁷ InterVISTAS Consulting Inc. (2015).

The InterVISTAS study shows a clear growth in terms of routes, passenger traffic, the number of departures, and capacity that could be attributed to the Australia-New Zealand agreements 1996 and 2002. However, a look at the exercise of cabotage services by Australian airline in New Zealand (and vice versa) shows less pronounced results.

Based on the scheduled services in the Australian and New Zealand domestic markets from 2004 to 2017, we found the following:

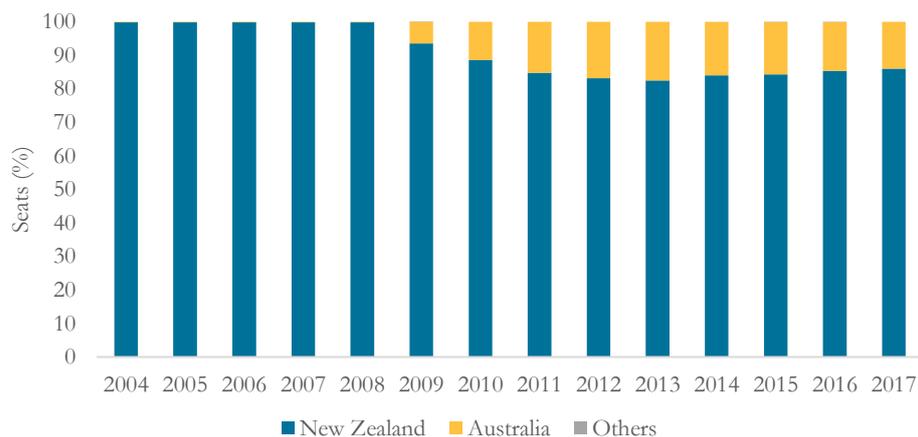
- Airlines established in Australia had consistently dominated the Australian domestic market in terms of seat capacity. Australian airlines had approximately 99% of the seat capacity while New Zealand airlines accounted for less than 1% share in the Australian domestic market during the same period, if any (see Figure 4).
- While New Zealand airlines made up a big majority of the seat capacity in the New Zealand domestic market, Australian airlines had a sizeable share of the market, recording up to 18% of the seat capacity. In 2017, 14% of the seat capacity in the New Zealand domestic market was attributable to Australian airlines and New Zealand airlines made up the remaining 86% (see Figure 5).

Figure 4: Market Shares in the Australian Domestic Market by Seats and Nationality of Airline, 2004 – 2017



Source: MAVCOM Analysis, AirportIS

Figure 5: Market Shares in the New Zealand Domestic Market by Seats and Nationality of Airline, 2004 – 2017



Source: MAVCOM Analysis, AirportIS

The difference between the penetration of Australian carriers in New Zealand and that of New Zealand carriers in Australia may be due to several factors such as geography, population, and the size of their airlines. Australia is larger than New Zealand in all three aspects. As the world's sixth largest country, Australia spans over approximately 7.7 million km² and has a population of about 24.1 million (compared to New Zealand's 4.7 million population and a territory of 268,000km²). Australia's main airlines group, Qantas, is also much bigger than Air New Zealand, its New Zealand counter-part. In FY2017, the Qantas group had a fleet of 309 aircraft, carried 53.6 million passengers and made AUS1.4 billion of profit before tax⁷⁸. Comparatively, the Air New Zealand group had 109 aircraft, carried approximately 16.0 million passengers and made NZD527 million of profit before tax⁷⁹. As such, Australian carriers are in a better position to take advantage of the single aviation market to provide cabotage services in the New Zealand than vice versa.

Case Study: Comparing Malaysia-Chile ASA and Malaysia-UK ASA

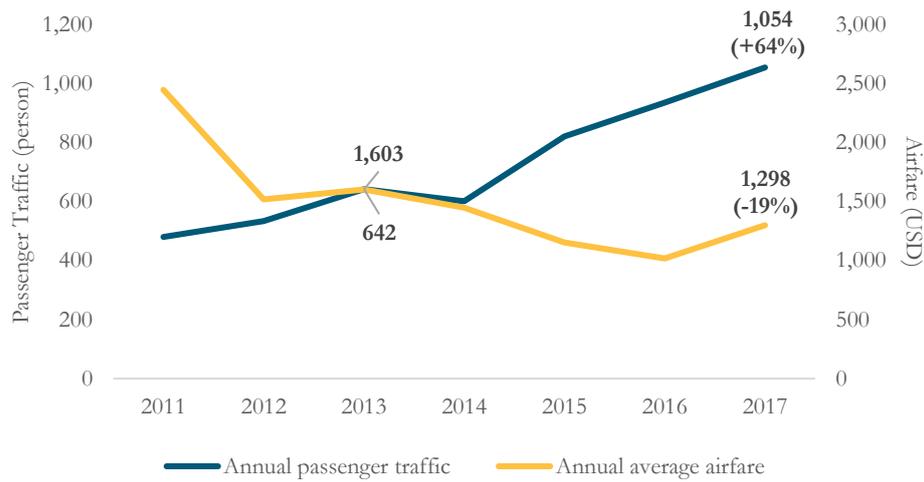
The Malaysia-Chile ASA is one of the more liberal ASAs entered into by Malaysia. The bilateral ASA provides up to the sixth freedom right between the two countries with no restriction in terms of capacity or routes. The Malaysia-Chile ASA entered into force in 2013.

Despite the liberal provisions under the Malaysia-Chile ASA, the traffic flow between the two countries remained low in terms of actual number of passengers (see Figure 6). The number of O&D passengers between Malaysia and Chile was 642 in 2013 and 1,054 in 2017. However, the average airfare in 2017 (USD1,298) was lower than that of 2013 (USD1,603).

⁷⁸ Qantas (2017).

⁷⁹ Air New Zealand (2017).

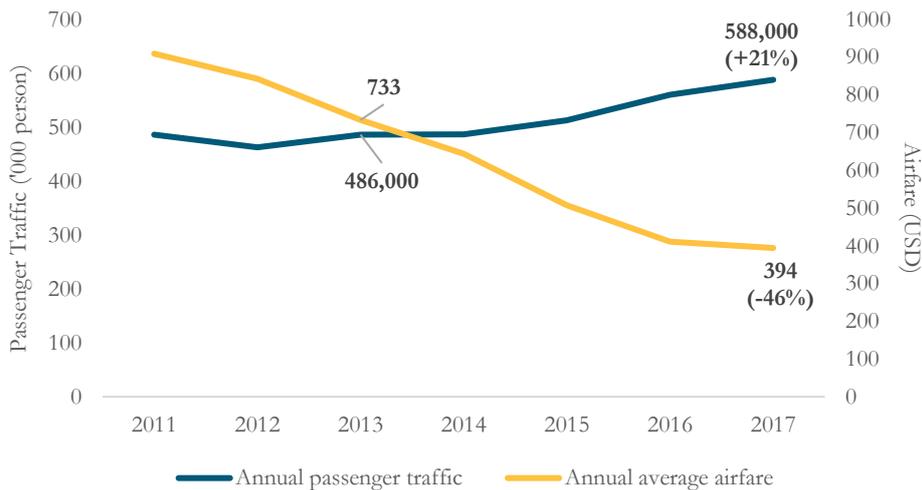
Figure 6: Passenger Traffic and Airfare Between Malaysia and Chile, 2011 – 2017



Source: MAVCOM Analysis, AirportIS

In comparison, Malaysia had also entered into an ASA with the UK in 1973 with the most liberal arrangements agreed in 2013 through an Agreed Record, which provides up to the ninth freedom right with no route or capacity restriction. Figure 7 shows that the number of O&D passengers between Malaysia and the UK had increased by approximately 100,000 persons between 2013 and 2017.

Figure 7: Passenger Traffic and Airfare Between Malaysia and the UK, 2011 – 2017



Source: MAVCOM Analysis, AirportIS

The difference in passenger traffic between Malaysia-Chile and Malaysia-UK (despite having liberal ASAs) may be attributed to factors such as geography and the intensity of economic activities between the States. Malaysia and the UK enjoy strong economic ties with substantial trade activities, recording a total import/export value of MYR16.4 billion in 2017⁸⁰. Also, the UK ranked ninth in 2017 based on the number of tourists received by Malaysia according to nationality, with a total of approximately 359,000 tourists⁸¹. This contrasts to Malaysia and Chile, which are more than 16,000km apart and have a bilateral import/export value of only MYR1.5 billion in 2017. Figure 8 shows Malaysia’s total import/export with Chile and the UK from 2011 – 2017.

Figure 8: Malaysia’s Import and Export Value with Chile and the UK, 2011 – 2017



Source: MAVCOM Analysis, Department of Statistics, Malaysia

In conclusion, even though Malaysia and Chile have entered into a liberal ASA, its impact on their bilateral market is negligible possibly due to the weak trade and tourism connections between the States, which is further exacerbated by their physical distance. In comparison, the growth in passenger traffic between Malaysia and the UK following from their liberal ASA is more significant, with them having substantial economic ties. This shows that the mere presence of a liberal ASA does not guarantee a substantial growth in the passenger flow between the Parties. Instead, other factors, such as economic activities between the States, would heavily influence the impact of a liberal ASA.

⁸⁰ Department of Statistics, Malaysia.

⁸¹ Tourism Malaysia and Immigration Department, Malaysia.

Case study: Chile's unilateral liberalisation of cabotage rights

Prior to 1979, the domestic air transport in Chile could only be performed by Chilean airlines. This policy changed in 1979 upon the enactment of the Commercial Aviation Act which applies an open skies commercial aviation policy in Chile. By virtue of that Act, Chile unilaterally allowed any airline from any State to provide unrestricted cabotage services in Chile, subject to the applicable safety and technical requirements. The Chilean Civil Aviation Board reaffirmed this policy in 2012 by declaring that foreign airlines shall have free access to the Chilean domestic market without demanding reciprocal concession for Chilean operators⁸².

The objectives of the unilateral cabotage policy of Chile are to generate actual or potential conditions of greater competitiveness in the domestic air transport market and to facilitate the entry and participation of foreign passenger and cargo operators, thus, promoting improved air services for the benefit of its people. Also, Chile's cabotage policy might have been pursued as an incentive to persuade other countries to liberalise their markets in light of the international expansion of its national carrier, LAN Airlines (now known as LATAM Airlines), which is the biggest airline in the Latin American region. Additionally, Chile's liberal policy may also be attributed to its geographical need for aviation services⁸³.

In addition, Chile signed regional and bilateral ASAs that grant cabotage right including the Multilateral Agreement on Open Skies of the Latin American Civil Aviation Commission, and the ASAs with multiple countries including Bahrain, El Salvador, Iceland, Kuwait, Macedonia, Paraguay, Qatar, the UK, the UAE, and Uruguay.

Chile's cabotage policy has led to the entry of foreign airlines from other States, such as Mexico, Uruguay, Sweden, and the US, into its domestic markets. However, the domestic services of the foreign airlines were only operated for a limited period of time. For example, a Mexican passenger airline and a Swedish cargo airline operated domestic services in Chile between 2012 and 2013⁸⁴.

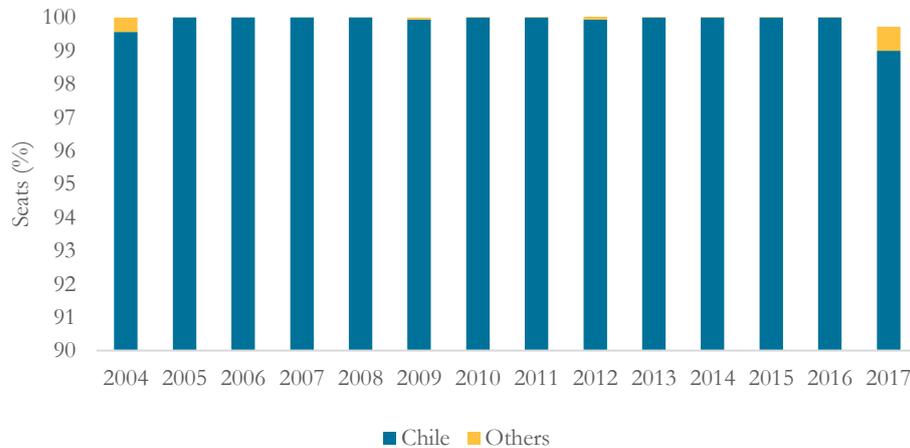
⁸² Opening of Cabotage in Chile, A39-WP/440, EC/40 (2016).

⁸³ Agama and Alisigwe (2018).

⁸⁴ Opening of Cabotage in Chile, A39-WP/440, EC/40 (2016).

Despite Chile’s liberal policy regarding cabotage since 1979, a study carried out by InterVISTAS found that, in 2007, the Chilean domestic market was wholly dominated by Chilean carriers, LATAM Airlines and Sky Airline. Similarly, our review of the Chilean domestic market from 2004 to 2017 shows that Chilean airlines had consistently provided 99% – 100% of the domestic seat capacity. Foreign airlines provided less than 1% of the Chilean domestic seat capacity in 2004, 2009, 2012, and 2017 (see Figure 9).

Figure 9: Market Shares in the Chilean Domestic Market Based on Seats and Nationality of Airlines, 2004 – 2017



Source: MAVCOM Analysis, AirportIS

The Chilean domestic market is comparable to that of Australia (Figure 4). In both markets, their domestic airlines accounted for at least 99% of the respective domestic market shares. This may be due to the fact that both Chile and Australia have strong national carriers that are dominant in their respective regions.

The Chilean experience shows how the unilateral cabotage liberalisation policy was used as a means to liberalise its domestic market and influence the liberalisation of the domestic markets of other States, allowing its national carrier to entrench its position in the region. Within Chile, the cabotage policy has had little effect with its strong local airlines continuing to dominate the domestic market.

Allocation of ATRs

As explained above, ATRs refer to the market access rights obtained by countries for the benefit of their airlines, often through bilateral or regional ASAs. Such ATRs may be exercised by airlines of the Parties subject to the provisions of the ASAs⁸⁵ and the domestic laws of the Parties.

With regard to the latter, a State has the prerogative to regulate the exercise of ATRs by its national airlines. States have adopted different approaches in regulating the exercise of ATRs for international routes by their national airlines. To illustrate this point, Box 2 provides examples of ATRs allocation as implemented by Malaysia, Australia, and Singapore. The criteria considered by the authorities in Malaysia, Australia, and Singapore in allocating ATRs are generally similar. Amongst others, all three jurisdictions would consider factors relating to: the performance of the airlines and their ability to serve the specified route and capacity; the market and competition on the route; and the effects of the requested services to the consumers. It is further observed that Australia's law specifically provides that, in allocating ATRs with regards to routes where capacity is not limited under an ASA, the authority will only assess the airline's ability to obtain the necessary approvals to serve and implement the route service as per its application.

⁸⁵ Such as the nationality requirement relating to the designation and authorisation of airlines (see Section 3).

Box 2: Allocation of ATRs in Malaysia, Australia, and Singapore

Allocation of ATRs in Malaysia

In Malaysia, the Government of Malaysia, through the MOT, procures ATRs by negotiating and entering into ASAs with other States. In turn, the administration, allocation and management of international ATRs procured under ASAs are carried out by MAVCOM as the economic regulator of the Malaysian civil aviation industry⁸⁶.

Section 66 of Act 771 provides that MAVCOM shall be responsible in administering, allocating and managing ATRs for both domestic and international routes. In doing so, MAVCOM may consider relevant factors including:

- the performance of the airlines in providing air transport services;
- the effect on consumers, the civil aviation industry, and the public interest;
- the benefits of allocating ATRs on the same route to two or more airlines; and
- the competition between the airlines in providing air transport services.

The ATRs allocation is implemented by way of a transparent and inclusive process that applies to both domestic and international ATRs allocation. Upon the receipt of an application by a Malaysian airline for the ATRs on a particular route, MAVCOM will notify all other Malaysian airlines. These other airlines may submit competing bids, or submit objections, reservations or representations to the application, within a specified period. Upon considering all the relevant factors and feedback from the other airlines, MAVCOM will decide on the allocation of the said ATRs. An ATR certificate will be issued to the successful airline.

In addition, MAVCOM's decision regarding to the allocation of ATRs is published on its website, as well as a summary of the ATRs under the ASAs entered into by Malaysia.

Currently, MAVCOM is finalising the draft regulations to further prescribe matters pertaining to the ATRs allocation, in addition to Section 66 of Act 771.

Allocation of ATRs in Australia

In Australia, the International Air Services Commission is responsible for the allocation of ATRs to Australian airlines for the operation of international airline services.

The International Air Services Commission is established under the International Air Services Commission Act 1992 to enhance the welfare of Australians by promoting economic efficiency through competition in the provision of international air services, resulting in: increased responsiveness by airlines to the needs of consumers, including an increased range of choices and benefits; growth in Australian tourism and trade; and the maintenance of Australian carriers capable of competing effectively with airlines of foreign countries.

⁸⁶ Section 66 of Act 771 provides that MAVCOM has the power to administer, allocate and manage ATRs for both domestic and international routes.

The International Air Services Commission applies the public benefit criteria in allocating ATRs. In assessing the public benefit, the Commission will, first and foremost, consider whether the Australian carrier is reasonably capable of obtaining the necessary approvals to operate on the route and implementing their applications⁸⁷.

In addition, the Commission may also consider the competition benefits arising from such allocation of ATRs including —

- the need for the Australian carriers to be able to compete effectively with one another and the carriers of foreign countries;
- the number of airlines on a particular route and the existing distribution of capacity between Australian airlines;
- the prospects for lower tariffs, increased choice and frequency of service, and innovative service differentiation; and
- the extent to which the airlines are proposing to provide capacity on aircraft they will operate themselves.

Other public benefits that may be considered by the International Air Services Commission are the consumer benefits⁸⁸, the trade benefits⁸⁹, the industry structure⁹⁰, and any other criteria as it considers relevant.

ATRs allocation in Singapore

Singapore has established the Air Traffic Rights Committee under the Air Navigation (Licensing of Air Services) Regulations for the purpose of allocating ATRs by way of licences for scheduled journeys under ASAs.

Singapore's Air Navigation (Licensing of Air Services) Regulations provide an extensive list of matters that may be considered by the Air Traffic Rights Committee when considering an application for the grant or renewal of a licence to provide scheduled air services under an ASA. They include:

- the nationality of the airline including the place of incorporation and the nationalities of persons who hold substantial ownership and effective control of the airline⁹¹;

⁸⁷ In allocating ATRs with regards to routes where capacity is not limited under a bilateral agreement, the Commission shall assess an airline's application only based on its capability to obtain the necessary approvals to operate on the route and implement the application. Paragraph 6.1, International Air Services Policy Statement No. 5 dated 19 May 2004, http://iasc.gov.au/about/annual_report/2016_2017/appendix6.aspx as accessed on 2 September 2018.

⁸⁸ In assessing consumer benefits, the International Air Services Commission will have regard to the degree of choice such as in terms of airports, seat availability, and range of services, efficiencies, the stimulation of innovation, and route service possibilities.

⁸⁹ In assessing trade benefits, the International Air Services Commission will consider the availability of frequent, low cost, reliable freight movement for Australian exporters and importers.

⁹⁰ In this regard, the Commission will assess the extent to which applications will impact positively on the Australian aviation industry.

⁹¹ Regulation 2H(5) of the Singapore's Air Navigation (Licensing of Air Services) Regulations provides that the Committee may refuse to grant or renew an Air Traffic Rights Application Certificate if the applying airline is not a citizen of Singapore, or not a company incorporated in Singapore which the Committee considered to be substantially owned and effectively controlled by the Government or citizens of Singapore or both.

- the financial resources of the airline and the ability to maintain adequate, satisfactory, safe, and efficient air services;
- the availability of the relevant ATRs;
- the details of the airline's proposed air services including:
 - the cities to be served and the routes to be provided;
 - the aircraft types;
 - the frequency, capacity and timetable of the proposed air services;
 - the types of traffic to be carried;
 - the tariffs to be charged and conditions of tariffs;
 - the expected load factors;
 - the expected load factors that must be achieved to avoid any financial loss in providing the said air services;
 - the proposed commencement date of the air services and the ability of the airline to enter the air services market quickly;
 - the nature of the air services to be provided, including any joint services, code-sharing and other arrangements to be entered into with any other airline;
 - the airline's business strategy; and
 - the international civil aviation requirements relating to operational and safety standards.
- the provision of air services by other airlines along the relevant routes;
- the demand for air services along the relevant routes;
- the past performance of the applying airline in respect of any air services provided;
- the extent to which tourism and international trade can be promoted;
- the extent to which Singapore can be promoted as an air hub;
- the public benefits, including the availability of effective, efficient, economical and safe air services; and
- the extent to which good relations and cooperation (particularly in respect of provision of air services) with foreign governments can be fostered.

SECTION 3: AIRLINE NATIONALITY REQUIREMENT UNDER ASAs

The ATRs agreed by States under an ASA may only be exercised by an airline that is designated by one Party and authorised by another Party to operate the agreed services. The designation and authorisation are subject to the airline fulfilling the nationality requirement provided in the ASA, implemented through the domestic regulations of the designating Party. Underlying the designation and authorisation requirements is the principle that only airlines that are considered as nationals of a Party to an ASA shall enjoy the rights provided in that agreement. This section discusses the different approaches towards the nationality requirement for airlines under the ASAs and the domestic regulations, as well as, the effects of liberalisation of the airline nationality requirement.

Justifications for the Airline Nationality Requirement

The airline nationality requirement was developed due to several reasons including security and national prestige, and protectionist policy⁹².

In the early years of modern international air transport that witnessed the First and Second World Wars, airlines were regarded as having significant military potential and constituting a form of public utility that should be State-owned/supported and strictly regulated⁹³. The protection of national security remained a primary basis for the imposition of the nationality requirement from the 1920s to the 1940s, and throughout the Cold War⁹⁴. The US and its allies feared that an enemy State could gain control of a third State's airline and enter their airspace via the exercise of the ATRs under an ASA. Thus, for security reasons, there was a need to ensure that the ATRs under an ASA would only be exercised by the Parties to the agreement and their airlines. States also favoured the imposition of the airline nationality requirements for the possibility of using such nationally-owned and controlled civilian aircraft for military or other strategic uses⁹⁵.

In addition, airlines were seen as symbols of national prestige, as almost all airlines during the negotiation of the Chicago Convention were State-owned and regarded as “flag carriers”.

⁹² Lelieux (2003); Havel and Sanchez (2014).

⁹³ Walulik (2016).

⁹⁴ Lelieux (2003).

⁹⁵ Such as to provide civil defence or meet emergency needs during crisis situations. Isabelle Lelieur (2003).

States also had the interests to protect their national airlines. The nationality requirement effectively limits access to the markets under an ASA to the airlines of the Parties. This gives an opportunity to the national airlines of the Parties to capture the business for air services agreed under the ASA. Also relevant is the preamble of the Chicago Convention which refers to the establishment of international air transport services on the basis of equality of opportunity. Many States had claimed that the Preamble provides for a guarantee of a legitimate national share in the international aviation market⁹⁶. Additionally, in some ASAs, the rights of airlines under the agreement are enforceable through a State-State dispute settlement mechanism such as arbitration. In this regard, States may prefer to provide diplomatic protection under ASAs only to the airlines that are owned and controlled by their nationals⁹⁷.

In more recent times, States have justified the retainment of the nationality requirement based on economic, safety, and security concerns. With the increase of privatisation, number of airlines, and competition in the airlines industry, ownership restrictions have become a means of protecting national airlines from foreign competition. States have also expressed their concerns on safety and security concerns that may arise from the liberalisation of the airline nationality requirement, such as the potential emergence of “flags of convenience”⁹⁸ and the possible flight of foreign capital that could lead to less stable operation⁹⁹.

Different Approaches Regarding Airline Nationality Requirement under the ICAO Template ASA

In general, Article 3 of the ICAO Template ASA provides that a State shall have the right to designate one or more airlines to operate the agreed services in accordance with the ASA¹⁰⁰. In addition, Article 3 provides that the Parties shall authorise a designated airline to operate air services under the ASA if that airline fulfils any of the following three nationality requirements (or a combination thereof):

- **Substantial ownership and effective control:** this refers to the requirement that an airline must be substantially-owned and effectively-controlled by the designating Party or its national. The terms “substantial ownership” and “effective control” are not defined. The ICAO Template ASA notes that “substantial ownership” is broadly considered to mean more than 50% equity ownership. Nevertheless, these terms are often governed by the national laws of the States which have applied the terms differently (further explained below).

⁹⁶ Walulik (2016).

⁹⁷ Under customary international law, the nationality of a company is determined by the place of incorporation of the company, not by the shareholders’ nationality, as per the International Court of Justice’s decision in the Barcelona Traction case. The Court further stated that States can agree by treaty to accord diplomatic protection to a company based on the nationality of the shareholders, such as in bilateral investment treaties and ASAs.

⁹⁸ This refers to the establishment of an airline in a different State in order to avoid strict regulations of the home State including in terms of safety, security, and labour standards.

⁹⁹ ICAO Secretariat, Liberalising Air Carrier Ownership and Control, ATConf/5-WP/7 (2002).

¹⁰⁰ Article 3 of the ICAO Template ASA provides that the traditional approach encompasses the single designation principle, where a State shall have the right to designate only one airline to operate the agreed services under the agreement. On the other hand, the transitional and full liberalisation approaches provide for the right of a State to designate more than one airline, which is known as multiple designation principle.

- **Principal place of business:** this requires an airline to have its principal place of business in the territory of the designating Party. In determining whether an airline has a principal place of business in the designating Party, the following factors may be considered: the place of establishment and incorporation of the airline; the existence of a substantial amount of the airline's operations and capital investments (including in physical facilities); the payment of taxes to the designating Party; the registration and bases of its aircraft; and the employment of a significant number of nationals of the designating Party in managerial, technical, and operational positions.
- **Effective regulatory control:** this requires the designating Party to have effective regulatory control over an airline to ensure compliance with safety and security standards under its national laws, consistent with the ICAO standards. A designating Party may be regarded as having an effective regulatory control if: an airline holds a valid operating licence or permit issued by the relevant licensing authority (such as an Air Operator's Certificate); meets the criteria of the designating Party for the operation of international air services; and the designating Party has safety and security oversight programmes in compliance with ICAO standards¹⁰¹.

Article 3 of the ICAO Template ASA incorporates three formulations for the designation and authorisation of airlines under a bilateral ASA to reflect the traditional, transitional, and full liberalisation positions:

- The traditional approach adopts the substantial ownership and effective control requirements for the designation and authorisation of an airline under an ASA.
- The transitional approach provides for two options for States to adopt under an ASA:
 - The first option requires the designated airline to fulfil the substantial ownership and effective control elements.
 - The second option requires that the principal place of business of the designated airline is in the territory of the designating Party and that the airline is under the effective regulatory control of the designating Party.
- The full liberalisation approach only requires that the designating Party has effective regulatory control over the designated airline.

¹⁰¹ UK Civil Aviation Authority (2006).

The main elements of the traditional, transitional, and full liberalisation approaches regarding airline nationality under the ICAO Template ASA are as per Table 12.

Table 12: Approaches Relating to Airline Nationality under the ICAO Template ASA

Elements	Traditional	Transitional	Full Liberalisation
Substantial ownership and effective control	✓	✓	
Principal place of business and effective regulatory control		✓	
Effective regulatory control			✓

Source: ICAO Template ASA

Most States Adopt the Substantive Ownership and Effective Control Requirements

Based on the ASAs entered into by States and their respective domestic laws, the substantive ownership and effective control requirements are the most prevalent in relation to the designation and establishment of airlines.

Airline nationality requirement under the ASAs

According to ICAO, almost 89% (2,579 out of 2,913) of the bilateral ASAs impose the ownership and control requirements for designated airlines. On the other hand, only 316 ASAs provide for the principal place of business requirement and 142 ASAs recognised the designation of community carriers (see Table 13)¹⁰².

Table 13: Number of ASAs by Type of Airline Nationality Requirement

Airline Nationality Requirement	Number of ASAs
Substantial ownership and effective control	2,579
Community of interest	142
Principal place of business	316

Source: ICAO WASA

ICAO has also carried out a survey on its Member States with regard to their policies, positions, and practices regarding the conditions attached to the designation of their own airlines and foreign airlines. The questionnaire also asked the States on their positions for the future of airline nationality requirements. To date, a total of 80 countries had responded to the questionnaire¹⁰³. A summary outcome of the survey based on the States' responses is provided in Table 14.

¹⁰² The ASAs that recognise the designation of community carriers were mostly in relation to the EU.

¹⁰³ https://www.icao.int/sustainability/pages/Eap_ER_Databases_StatePolicies_Replies.aspx, accessed on 29 August 2019.

Table 14: Outcome of the ICAO Questionnaire on States' Policies, Positions and Practices on Ownership and Control of Airlines

ICAO Questionnaire on States' Policies, Positions and Practices on Ownership and Control of Airlines	Number and Percentage of States		
	Yes	No	Case-by-case
In designating an airline under an ASA			
- <i>Require substantial ownership and effective control by nationals</i>	46 (58%)	23 (29%)	10 (13%)
In the designation of foreign airlines			
- <i>Accept designation based on substantial ownership and effective control by the designating Party or its nationals (the traditional approach)</i>	62 (84%)	2 (3%)	10 (14%)
- <i>Accept designation based on substantial ownership and effective control by one or more States that are Parties to an agreement or within a predefined regional grouping (a community of interest)</i>	22 (38%)	10 (17%)	26 (45%)
- <i>Accept designation based on the place of incorporation and principal place of business or permanent residence requirements</i>	25 (47%)	10 (19%)	18 (34%)
- <i>Accept designation based on the airline's principal place of business and effective control requirements (without the ownership requirement)</i>	17 (35%)	15 (31%)	17 (35%)
- <i>Accept designation based on the principal place of business and effective regulatory control requirements</i>	30 (58%)	8 (15%)	14 (27%)
In the future designation of airlines			
- <i>Willing to accept criteria other than ownership and control for both yourself and the foreign partner</i>	40 (62%)	9 (14%)	16 (25%)
- <i>Willing to accept criteria other than ownership and control for the foreign partner but maintain traditional criteria for yourself</i>	12 (22%)	26 (48%)	16 (30%)
To facilitate liberalisation of airline ownership and control			
- <i>Willing to consider issuing an individual statement of policy for accepting designations of foreign air carriers</i>	24 (45%)	24 (45%)	5 (9%)
- <i>Willing to consider developing a common policy with partner States</i>	31 (57%)	15 (28%)	8 (15%)

Source: ICAO

The outcome of the questionnaire clearly shows that in designating airlines, a majority of the States (58%) required their airlines to be substantially-owned and effectively-controlled by their nationals. Conversely, approximately one-third of the respondents stated that the substantial ownership and effective control requirements do not apply to their airlines. The remaining ten States responded that the ownership and control requirements will be applied on a case-by-case basis. An example is Germany who answered that the substantial ownership and effective control requirements are applied on a case-by-case basis based on the relevant bilateral ASA and as far as it is consistent with the EU agreements¹⁰⁴.

In comparison to the designation of their own airlines, States appeared to be more open with regard to the designation of foreign airlines:

- 47% answered that they would accept the designation of a foreign airline based on the sole requirement of principal place of business while another 34% would accept the same on a case-by-case basis.
- States were almost equally divided in their willingness to accept the transitional approach for the designation of foreign airlines (based on the principal place of business and effective control requirements, or the principal place of business and effective regulatory control requirements).

As stated above, the survey also asked about the States' willingness to accept criteria other than the national ownership and control requirements. Interestingly, 62% of the States were willing to accept other criteria for the designation of airlines for themselves and their foreign partners, compared to 48% that would maintain the traditional criteria for themselves but were open to accept any other criteria for their foreign partners.

Finally, States appeared to be more willing to develop a common policy with their partner States to facilitate the liberalisation of the airline nationality requirement, in comparison to the issuance of an individual policy statement for the acceptance of designations of foreign carriers.

Airline nationality requirement under the national laws

As noted above, the airline nationality requirement contained in the ASAs is implemented by the respective national laws of the States. States commonly establish and define the nationality requirement under their airline licensing regime, consistent with the nationality requirement in their ASAs.

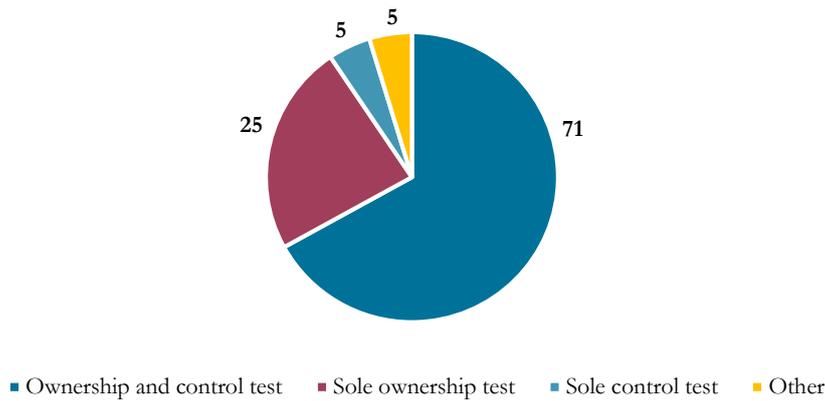
Walulik (2016) had studied the practices of more than 100 countries on their nationality requirements for airlines. The study found that a majority of the countries (71 out of 121) applied the substantial ownership and effective control requirements to their airlines. However, Walulik's study also showed that not all States apply both the ownership and control requirements under their domestic laws. Instead, 25 countries required the sole substantial ownership requirement under their national systems¹⁰⁵, while five countries applied only the effective control requirement (see Figure 10)¹⁰⁶.

¹⁰⁴ https://www.icao.int/sustainability/OwnershipControl/Replies/Germany_07.pdf, accessed on 29 August 2018.

¹⁰⁵ Examples are Botswana and Brazil.

¹⁰⁶ According to the study, the five countries that applied the control requirement only are Colombia, Jamaica, Mozambique, Nicaragua, and Nigeria.

Figure 10: Application of the Airline Ownership and Control Requirements by States Under Their Domestic Systems

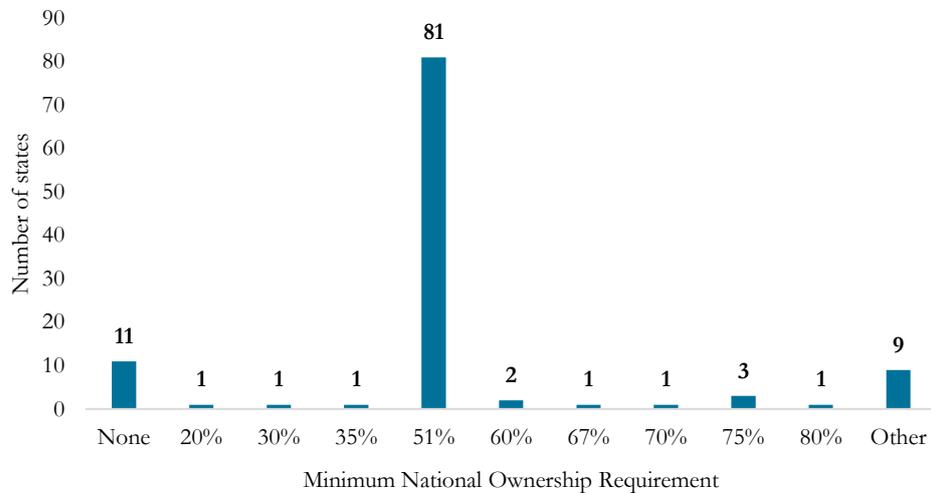


Source: Walulik (2016)

In addition, Walulik (2016) also found that there were different applications of the substantial ownership criterion. First and foremost, certain States distinguished between domestic airlines and international airlines in terms of the national ownership requirement. For example, the study found that the Dominican Republic, Nepal, Panama, and South Africa apply stricter foreign ownership rules for domestic airlines compared to international airlines. This could be interpreted as a measure to protect the domestic industry. Meanwhile, Australia's policy is the opposite; no foreign ownership limit is imposed for domestic airlines but for international airlines, the substantial ownership and effective control requirements apply.

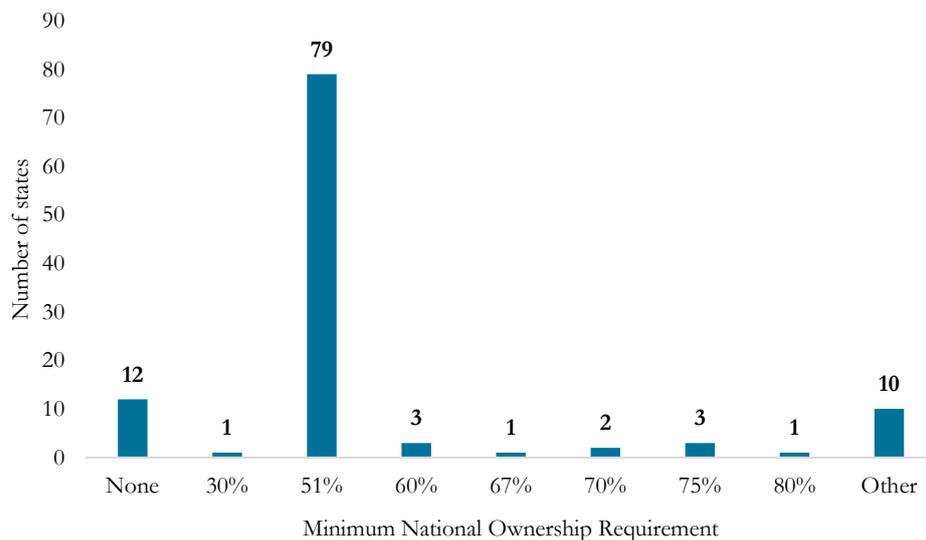
In light of such differentiated policies between domestic and international airlines, the study observed the minimum national ownership requirement applied by States for domestic and international airlines, respectively (see Figures 11 and 12).

Figure 11: Minimum National Ownership Requirement for International Carriers



Source: Walulik (2016)

Figure 12: Minimum National Ownership Requirement for Domestic Carriers



Source: Walulik (2016)

The study found that while the minimum percentage of national ownership ranged widely between 0% and 80%, most States required that their nationals have at least 51% stake in their airlines, irrespective of domestic or international airlines.

The substantial ownership and effective control requirements also prevail in ASEAN

Consistent with the global trend, the majority of ASEAN Member States, including Malaysia, require that their airlines be substantially-owned and effectively-controlled by their respective nationals (see Table 15). The exceptions are Cambodia and Lao PDR—both States allow foreign nationals to own up to 100% of a local airline. The open policies are adopted by Cambodia and Lao PDR to address the lack of domestic capital and to attract more foreign investment into their aviation industry to stimulate sectoral growth.

Table 15: ASEAN Member States' Policies on Airline Nationality Requirement

ASEAN Member State	Policy on Airline Nationality Requirement
Brunei	Requires substantial ownership and effective control by Bruneian national
Cambodia	No national ownership requirement. Allows up to 100% foreign ownership of an airline
Indonesia	Allows up to 49% foreign ownership of an airline
Lao PDR	No national ownership requirement. Allows foreign entities to own 100% of an airline, or to form a joint venture with a national entity
Malaysia	Allows up to 49% foreign ownership of an airline
Myanmar	The Government of Myanmar has the sole right to operate the airline business. However, the Government may allow other entities to carry out the airline business if it thinks that it will bring benefits to the public. In the case of the latter, Myanmar allows up to 49% foreign ownership of an airline
Philippines	Allows up to 40% foreign ownership of an airline ¹⁰⁷
Singapore	Requires substantial ownership and effective control by Singaporean national ¹⁰⁸
Thailand	Allows up to 49% foreign ownership of an airline
Vietnam	Allows up to 30% foreign ownership of an airline, and the majority share must be held by a Vietnamese national

Source: ASEAN Transport Working Group

We note that the issue of ownership and control of airlines is identified as one of the economic elements under the ASEAN Single Aviation Market. However, the intra-ASEAN liberalisation of the ownership and control requirements or the establishment of ASEAN community carriers does not seem to be of priority to ASEAN Member States as it is neither identified nor mentioned in the ASEAN Transport Strategic Plan 2016 – 2025.

¹⁰⁷ The Philippines is amending its constitution, which would allow up to 100% foreign ownership in airlines.

¹⁰⁸ In the case of Singapore, the substantial ownership and effective control requirements will be considered by the Air Traffic Rights Committee in assessing the authorisation of ATRs to any airline established in Singapore. An application for ATRs by an airline that fails to fulfil these conditions will be rejected. In this regard, while the substantial ownership and effective control requirements are not conditions for establishment per se, these requirements must be fulfilled by any airline established in Singapore that seeks to operate scheduled services. However, any airline that is a designated carrier under a bilateral, plurilateral or multilateral ASA with Singapore is excluded from this rule (Civil Aviation Authority of Singapore, 2018).

However, ASEAN ASAs such as the MAAS and the MAFLPAS do provide alternative approaches regarding airline nationality, making it possible for ASEAN Member States to depart from the traditional ownership and control requirements in the future. In particular, Article 3 of the MAAS and the MAFLPAS allows the designation to be based on the —

- substantial ownership and effective control;
- place of incorporation and principal place of business in the territory of the designating Party, substantial ownership and effective control by one or more ASEAN Member States and/or its nationals, and the effective regulatory control by the designating Party¹⁰⁹; or
- place of incorporation and principal place of business in the territory of the designating Party and the effective regulatory control by the designating Party¹¹⁰.

The second option above—which refers to the substantial ownership and effective control by one or more ASEAN Member States and/or its nationals—provides an avenue for the establishment of ASEAN community carriers. However, this possibility is currently limited as it is only exercisable subject to the acceptance by the authorising Party¹¹¹. At the moment, in contrast to the ASEAN Member States’ active liberalisation of ATRs in the ASEAN context, there appear to be a general reluctance to liberalise in terms of airline nationality.

Malaysia’s implementation of the substantial ownership and effective control requirements

As stated above, Malaysia adopts the substantial ownership and effective control requirements for the establishment and designation of airlines. Under Act 771, MAVCOM has the power to issue an air service licence to an airline that is established in Malaysia to undertake scheduled air services¹¹². It also has the power to prescribe the requirements for the issuance of such licence¹¹³.

Amongst the criteria considered by MAVCOM in assessing air service licence applications is whether the airline is a company incorporated in Malaysia and is directly or indirectly under the control of a Malaysian person, as well as the ownership structure of the airline.

¹⁰⁹ Subject to the acceptance by the other Party.

¹¹⁰ Subject to the acceptance by the other Party and provided that such arrangements will not be equivalent to allowing that airline or its subsidiaries access to ATRs not otherwise available to that airline. This option is also contained in Article 3 of the ASEAN-China ASA.

¹¹¹ Illustration: Malaysia designates Airline A, which is established in its territory, and substantially-owned and effectively-controlled by nationals of ASEAN States. If Airline A wishes to operate the agreed services under the MAAS or MAFLPAS on routes between Malaysia and Singapore, Singapore has the discretion to accept the designation and to authorise the airline, or to refuse the authorisation of the airline. On the other hand, if Airline A is established in Malaysia, owned and controlled by Malaysian nationals, and designated by Malaysia, Singapore has the obligation to authorise Airline A under the MAAS or MAFLPAS (subject to the other conditions under Article 3(2)(b) and (c) of the agreement).

¹¹² Section 35 of Act 771. Applicants are also required to apply to the Civil Aviation Authority of Malaysia for an Air Operator’s Certificate for their proposed operations. An air service licence will only be issued to an applicant who holds a valid Air Operator’s Certificate.

¹¹³ Section 39 of Act 771.

A person is considered as having control over a company if such person has an interest of more than 50% of the shares¹¹⁴ in the company, and any of the following:

- the power to elect, appoint, remove or prevent from election a majority of the directors of the company
- the power to make business or administrative decisions of the company
- the power to direct or instruct the directors, chief executive officer or senior officers of the company, formally or informally

MAVCOM may also deem the existence of control where it is satisfied that there are reasonable grounds to do so. In other words, it has the power to consider other factors in assessing whether a person has control over an airline.

For Malaysia, the element of ownership is considered as part of the control element. However, in practical terms, Malaysia applies the substantial ownership and effective control requirements for the establishment of its airlines. At present, MAVCOM is developing the regulations to prescribe these licensing requirements.

In relation to its foreign partners, Malaysia had indicated in its response to the ICAO survey that it may accept the designation of foreign airlines by other States based on the sole principal place of business requirement or the principal place of business and effective control requirements¹¹⁵. Such foreign designations will be considered by Malaysia on a case-by-case basis. For example, the Malaysia-Hong Kong ASA provides for the designation of Hong Kong's airlines based on the principal place of business requirement¹¹⁶. This position was taken by Malaysia in light of Hong Kong's domestic law that prescribes the principal place of business requirement for the establishment of an airline in its territory¹¹⁷.

In charting its future policies regarding airline nationality requirement, Malaysia should deliberate on whether there is a need to liberalise its airline nationality requirement in order to further develop its aviation industry. The factors that should be considered include the availability of domestic capital, as well as the effects of such liberalisation on the market, industry, and consumers, taking into account the experiences of other countries.

¹¹⁴ "Shares" means issued ordinary share other than preference share which confers the holder the right to attend, participate and speak at a meeting; the right to vote; the right to an equal share in dividends authorised by the board or the distribution of the surplus assets of the company.

¹¹⁵ https://www.icao.int/sustainability/OwnershipControl/Replies/Malaysia_07.pdf.

¹¹⁶ Article 4, Agreement Between the Government of Hong Kong and the Government of Malaysia Concerning Air Services (1992).

¹¹⁷ Air Transport Licensing Authority (n.d). It is noted that Hong Kong adopts the principal place of business requirement primarily to cater for its main airline, Cathay Pacific, which is part of the Swire group, a UK company. Historically, Hong Kong was a British colony with the autonomy over its ASAs. To get around the fact that Cathay Pacific was not owned by Hong Kong nationals, Hong Kong signed ASAs adopting the principal place of business principle for its designated airlines. Hong Kong's autonomy over ASAs continued even after its re-unification with China in 1997. Rigas Doganis (2006).

Effects of the Airline Nationality Requirement and Its Liberalisation

Issues arising from the prevailing ownership and control requirements, as well as the effects of such liberalisation are discussed below.

Issues arising from the application of the ownership and control requirements

There are ambiguities surrounding the exact definition of the nationality requirement for airlines, especially the prevalent ownership and control requirements.

In terms of substantial ownership, uncertainties may arise even if a State adopts a quantitative requirement of local ownership in an airline, such as the prevalent 51% national ownership requirement. Uncertainties may arise from the application of the ownership limit requirement to shares that entail voting or non-voting rights, or the ownership of shares by another company which may in turn be owned by a foreign national.

Additionally, it may be difficult to determine the precise configuration of an airline's ownership in modern complex corporate and commercial arrangements. Examples are securities that incorporate the right to buy shares of the issuing company¹¹⁸ and securities which may be exchanged for shares¹¹⁹. Such securities raise questions on whether they should be regarded as ownership interests at the time of their issuance, even before the option is executed. Moreover, with regard to a public-listed company, a nominee shareholder may hold the shares of the company for the benefits of a beneficial shareholder. In such scenario, while the nominee shareholder will be registered as the shareholder in the company's record, the identity of the beneficial shareholder may not be disclosed. Thus, the determination of the exact ownership of a company or airline may prove to be challenging, if not impossible.

Furthermore, the substantial ownership and effective control requirements are often criticised for limiting the financing opportunities available to airlines in terms of foreign investment and increasing airlines' reliance on government support. It may also hamper cross-border mergers and acquisitions, preventing the emergence of truly global airlines¹²⁰. Also, the ownership and control requirements may restrict the ability of airlines to better structure their international networks, thus, limiting the full potential of airlines, even in a market where ATRs are liberalised.

¹¹⁸ Such as company warrants.

¹¹⁹ Such as convertible bonds.

¹²⁰ WTO (2007).

Liberalisation of the airline nationality requirement

As stated above, most States adopt the substantial ownership and effective control requirements in the ASAs and their domestic regimes. However, a number of States have liberalised the nationality requirement for their airlines by applying the principal place of business requirement, the regulatory control requirement, and/or the ownership and control by a national of any Party within a group of States (such as the EU community carrier).

Given that the airline nationality requirement is governed at both the domestic and international levels, any liberalisation would necessarily entail changes to the States' domestic laws as well as amendments to the existing ASAs. Unilateral liberalisation of the airline nationality requirement by a State might have minimal impact. A foreign-owned airline established in a State would be limited to domestic operations, since other States may withhold their authorisation for that airline to provide international air services under the ASAs that contained the ownership and control requirements.

As mentioned above, the study by Piermartini and Rousova (2013) relating to the effects of the liberalisation of international ASAs on bilateral passenger flows¹²¹ found that free pricing and free determination of capacity combine with community of interest ownership regime would have the largest impact on passenger traffic.

The WTO also noted that the ownership of airlines by foreign persons were increasing. In the 1990s, the ownership of airlines by foreign persons was rare. Yet, in early 2001, over 160 airlines had foreign equity ownership and more than 57 carriers purportedly held shares in foreign airlines.

Case study: The EU community carrier and arising issues

The establishment of the EU community carrier is arguably the most extensive effort by States to liberalise the airline nationality requirement, which involves 28 EU Member States.

As part of the European Internal Aviation Market, the EU established the concept of an EU community carrier, which must: be substantially-owned¹²² and effectively-controlled¹²³ by the EU Member States¹²⁴ or their nationals; and have its principal place of business in an EU Member State, being the State that has granted a valid operating licence to the airline. The conditions for an EU community carrier are provided under Article 4 of the Regulation (EC) No. 1008/2008 on air services.

The establishment of the EU community carriers allows any EU Member State or its national to set up an airline in the territory of another EU Member State and to operate from any points within the EU. This effectively created a single intra-EU aviation market akin to a singular State.

¹²¹ The research focused on passenger flows instead of on airfares to account for the possibility that liberalisation affects airfares as well as the quality of air transport.

¹²² Substantial ownership refers to the ownership of more than 50% shares.

¹²³ Effective control refers to the exercise of decisive influence on the management of the air carrier.

¹²⁴ We note that the EU community carrier principle also extends to the European Economic Area (including Iceland and Norway) and Switzerland. However, for the purpose of this paper, reference is only made to the EU Member States.

In relation to the EU's external aviation relations, the EU has negotiated for the recognition of the EU community carrier concept under the ASAs with its partners. For example, in the EU-US ASA, the US accepted the community carrier clause to allow any EU airline to operate between any point in the US and any point in the EU. The EU airlines are allowed to commence services between points in the US and points in an EU Member State other than their own home country. The practical relevance of these opportunities has proven to be limited as the EU air carriers continue to operate from their traditional hubs for commercial reasons¹²⁵. Nevertheless, the community carrier clause facilitates mergers and acquisitions between EU airlines without jeopardising their right to operate international air services under ASAs entered into by the EU.

The following are some arising issues relating to the EU community carrier regime:

- **Brexit:** issues relating to the status of the EU community carriers in the UK have been raised in light of the UK's impending exit from the EU¹²⁶. The EC's position in this regard is clear: the UK's exit from the EU will render any operating licence held by an EU community carrier in the UK to be invalid due to failure to comply with the conditions under Article 4 of the Regulation (EC) No. 1008/2008 on air services. Also, from the date of the UK's withdrawal from the EU, the operating licences granted to airlines by the UK Civil Aviation Authority will no longer be valid EU operating licences¹²⁷.

Given that the UK is a major aviation market in the European region, Brexit will have a substantial impact upon the UK and the EU. The UK may attempt to negotiate a bilateral arrangement with the EU Member States and a horizontal agreement with the EU for it to continue enjoying the rights and privileges under the EU Internal Aviation Market akin to the EU's arrangements with the EEA members (Iceland, Lichstenstein, and Norway), the European Common Aviation Area members (Albania, Bosnia and Herzegovina, Iceland, Kosovo, Macedonia, and Norway), and Switzerland.

Another related issue arising from Brexit pertains to the ASAs entered into by the EU with a third party such as the US and Canada. At the moment, UK carriers enjoy rights as an EU community carrier in relation to their operations of the agreed services under the EU's ASAs with third parties. However, upon the UK's exit from the EU, the UK will automatically cease to be covered by the ASAs entered into by the EU. As a result, UK carriers will no longer enjoy ATRs under any EU's ASA, be it from/to the territory of the UK or any of the EU Member States. Similarly, air carriers of an EU Member State will no longer enjoy ATRs to/from the UK under the EU's ASAs.

¹²⁵ Burghouwt, De Leon, and De Wit (2015).

¹²⁶ The UK had submitted the notification of its intention to withdraw from the EU on 29 March 2017. Unless a ratified withdrawal agreement establishes another date, the UK will withdraw from the EU officially on 30 March 2019. Upon the withdrawal date, the UK will cease to become a Member State of the EU and all EU law will no longer apply to the UK.

¹²⁷ Directorate-General for Mobility and Transport, EC (2018).

At present, the UK is reportedly negotiating a new ASA with the US in preparation for its withdrawal from the EU. Amongst others, the UK is negotiating for the continued designation and authorisation of its carriers based on their ownership and control by EU nationals, instead of UK nationals. Brexit may also pose complications to certain major airlines such as Virgin Atlantic¹²⁸, British Airways and Iberia (owned by IAG)¹²⁹, and Norwegian Air UK¹³⁰ in terms of their ownership and control. On the other hand, Easyjet, a UK airline, had moved to establish an affiliate airline in Austria in 2017 to ensure that it continues to serve intra-EU markets after the Brexit¹³¹.

- **Ownership by nationals of a third Party:** in recent years, non-EU airlines have bought stakes in EU carriers. Even though the foreign ownership in the EU carriers did not exceed the 49% limitation, the EC had probed into the foreign holdings in EU carriers such as Delta Air Line's stake in Virgin Atlantic, Etihad's stake in Air Berlin, and Korean Air's shareholding in Czech Airlines¹³². The examination was carried out to determine whether these European airlines are indeed substantially-owned and effectively-controlled by an EU Member State or EU nationals, with emphasis on the control criterion. The question raised was whether these airlines are under the effective control of their respective foreign shareholders despite the shareholders having a minority (but substantial) share in the airlines. This goes to show the complexity of the implementation of the substantial ownership and effective control criteria, as mentioned previously.

In March 2018, the EC had launched a public consultation on the common rules for the operation of EU air carriers in the internal aviation market¹³³. Amongst others, the questionnaire asked whether it is important to limit foreign investment in the EU air carriers, and whether the current EU rules on ownership and control of EU air carriers should be abolished, relaxed on the basis of reciprocity, tightened (by reducing the foreign shareholding limit) or maintained without changes. This consultation is part of the EC's exercise to identify possible areas of concern with its current regulation focusing on factors that undermine competition and consumer protection, as well as risks of hampering innovation, affecting EU's carriers to maintain and develop their business globally, and consumer benefits. At the time of this paper's publication, the exercise is still ongoing.

¹²⁸ Virgin Atlantic is a UK-based carrier which is majority-owned by Sir Richard Branson (51%). He is in the process of selling 31% shares in Virgin to Air France-KLM in a joint venture transaction. If the transaction is completed, the status of the carrier as a UK carrier would come into question.

¹²⁹ British Airways and Iberia are both owned by IAG, a company registered in Spain with shares traded on the London Stock Exchange and the Spanish Stock Exchange. IAG's corporate head office is in London.

¹³⁰ Norwegian Air UK is a UK airline owned by Norwegian Air Shuttle.

¹³¹ Pustay (2018).

¹³² Thomson Reuters, Delta, Etihad under Scrutiny as EU Probes Foreign Holdings in Airlines (4 April 2014).

¹³³ <https://ec.europa.eu/transport/sites/transport/files/2018-airservicesregulation.pdf>, accessed on 13 September 2018.

SECTION 4: KEY DEVELOPMENTS AND FUTURE TRENDS

In light of the discussions in previous sections, a few key developments in the areas of ATRs and airline nationality requirement have been observed. These key developments are expected to continue and gain momentum, informing us on possible future trends in the economic development of international air transport.

The Continuous Pursuit of ATRs Liberalisation

We note that in general, States continue to seek more liberalised ATRs at the bilateral and regional levels to pursue their respective aviation policies, as well as trade and tourism objectives.

Liberalisation of ATRs as Part of States' Aviation Policies

Many countries have identified the liberalisation of ATRs as part of their aviation policies and strategies, such as the following:

- **India:** India aims to liberalise the bilateral rights regime to achieve greater ease of doing business and wider passenger choice as part of its ten-year plan for aviation. In particular, India prioritises “open skies” ASAs on a reciprocal basis with the SAARC countries¹³⁴ and the countries located outside the 5,000km radius from New Delhi. On the other hand, for countries within the said 5,000km radius, India will seek to renegotiate the capacity provided under existing restrictive ASAs in cases where Indian airlines have utilised 80% of their capacity entitlements and are seeking additional capacity¹³⁵.
- **The EU:** as part of its efforts to bolster the competitiveness of the European aviation sector, the EU has launched negotiations with targeted foreign partners with the aim of market access and ensuring fair competition in key international markets. The EU also seeks to create investment opportunities with third countries based on mutual liberalisation of the airline nationality requirement. The EU had entered into ambitious ASAs with the US and Canada between 2007 and 2010. In 2016, the EU Council mandated the EC to start negotiations on comprehensive ASAs with four key partners: ASEAN, Qatar, the UAE, and Turkey. The ASEAN-EU ASA is set to become the EU's first bloc-to-bloc ASA, while the UAE, Qatar, and Turkey are amongst the most dynamic and fastest-growing aviation markets¹³⁶. The negotiations with these key partners are currently ongoing. The EU has also identified Armenia, China, and Mexico for further aviation liberalisation.

¹³⁴ Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, and Sri Lanka.

¹³⁵ India National Civil Aviation Policy 2016.

¹³⁶ European Council (2016).

- **The UK:** amongst key objectives of the UK's aviation policy is to make it one of the best-connected countries in the world¹³⁷. To this end, it seeks to encourage new routes and services by continuing to liberalise bilateral and EU-level ASAs with other countries, enabling airlines to provide services freely on the basis of commercial considerations¹³⁸. However, the impact of the UK's impending exit from the EU (and subsequently the European Internal Aviation Market) on the UK's connectivity and aviation policy remains unclear.

Liberalisation of ATRs at the Bilateral and Multilateral Levels

To implement their aviation policies to further liberalise ATRs (as mentioned above), States are carrying out negotiations and entering into ASAs with their strategic aviation partners, especially at the bilateral levels.

A recent example of a bilateral liberalised arrangement is the Australia-India ASA that was signed in June 2018, driven by trade and tourism between the two States¹³⁹. Under this new ASA, Australia and India agreed to open capacity between their respective major airports. In particular, Australian airlines are allowed to operate unlimited services between Australia and Bangalore, Chennai, Hyderabad, Calcutta, Mumbai, and New Delhi, in exchange for the rights of Indian airlines to operate unlimited services between India and six major airports in Australia. At the time of the ASA signing, the direct services between Australia and India were solely provided by Air India¹⁴⁰, while Qantas and Virgin only served India via codeshares. This Australia-India ASA is consistent with the Parties' aviation policies, specifically India's policy of pursuing a liberalised ASA with any country located beyond 5,000km from New Delhi that allows unlimited flights directly connecting with major international airports in India¹⁴¹.

On the other hand, States having different priorities and expectations in negotiating for an ASA may hamper their liberalisation efforts. An example is the Brazil-EU negotiation for an open skies ASA which started in 2011 and went on for eight years. In December 2017, Brazil informed of its intention to end the negotiation stemming from the EU's refusal to grant Brazil the fifth freedom right. Following the stumbling block, Brazil may seek to update bilateral agreements with individual EU Member States instead.

¹³⁷ The UK Aviation Policy Framework (2013).

¹³⁸ The UK Aviation Policy Framework (2013).

¹³⁹ At present, India is Australia's seventh most valuable international tourism market with 302,200 visitors contributing AUD1.43 billion to the Australian economy in 2017. Australia estimated that the number of Indian visitors would rise to more than 640,000 by 2027¹³⁹. Moreover, the ASA would facilitate Australian businesses in accessing India's rapidly growing market. Indeed, the trade between the two countries are substantial, with India being the fifth largest trading partner for Australia. (Australian Department for Foreign Affairs and Trade, n.d)

¹⁴⁰ Air India offers 2,048 weekly seats with five times weekly services on the New Delhi-Sydney route and three times weekly services on the New Delhi-Melbourne route.

¹⁴¹ India's National Civil Aviation Policy 2016.

In addition to bilateral efforts to liberalise ATRs by States, ICAO is also attempting to liberalise ATRs at the multilateral level (as mentioned above). The ICAO Assembly had mandated the ICAO Council to “develop and adopt a long-term vision for international air transport liberalisation, including the examination of an international agreement by which States could liberalise market access”¹⁴². There is a lack of consensus amongst States on fundamental issues such as the scope and pace of liberalisation for such multilateral agreements, and the need for and coverage of the safeguard provisions. To move forward, ICAO may draft a “baseline agreement” that covers the common legal framework for market access liberalisation, and separate supplemental protocols that grant different levels of ATRs¹⁴³. Since such multilateral agreements are still in the process of drafting, the degree of the market access liberalisation under those agreements is unclear. It would also be interesting to see whether ICAO’s attempt at creating a multilateral ASA would be widely supported by States, unlike in previous attempts. If ICAO is successful in developing a widely-supported multilateral agreement that liberalises ATRs, it would be a huge step forward in the economic development of international air transport.

The Potential Emergence of Community Carriers

Unlike in the case of ATRs, States are more reluctant to liberalise the airline nationality requirement. In particular, States are likely to retain the airline ownership and control criteria in their domestic regimes and ASAs in the near future. Even though 40 States responding to the ICAO’s questionnaire (as mentioned in Section 2) said that they were willing to accept criteria other than ownership and control for themselves and their foreign partners in the future, there does not seem to be much momentum amongst States to support such liberalisation.

The EU, which is a key aviation jurisdiction, does seek to create investment opportunities with third countries based on mutual liberalisation of the airline nationality requirement. Thus far, the EU has yet to succeed in negotiating an ASA that liberalises the airline ownership requirement (other than the recognition of the EU community carriers by its foreign partners). For example, the EU-US ASA and the EU-Canada ASA only contain general provisions that allow for possible reciprocal liberalisation of the airline ownership requirement between the Parties in the future. There is no concrete commitment between the Parties in this regard.

Despite the lack of interest between States to move away from the ownership and control requirements for airlines, States may be more open to the adoption of a community carrier concept within a regional area. As mentioned above, ASEAN’s MAAS and MAFLPAS do contain provisions that provide for the possibility of the establishment of ASEAN community carriers. As ASEAN Member States seek further liberalisation within their regional market, the acceptance of an ASEAN community carrier may be regarded as a vital step to achieve an ASEAN Single Aviation Market in its truest sense. The establishment of an ASEAN community carrier may also address the issue of unbalanced market access between ASEAN and its Dialogue Partners, such as the situation under the ASEAN-China ASA. However, the political will amongst ASEAN Member States to establish ASEAN community carriers is unclear. Given that any decision made by ASEAN is based on consensus, the establishment of ASEAN community carriers, while possible, may take a long time.

¹⁴² ICAO (2017).

¹⁴³ ICAO (2017).

The Rising Prominence of Competition Law

The concept of competition is not alien to international air transport, despite it being heavily regulated by States, historically. ICAO has adopted the fair competition principle in relation to the operation of international air transport. This is consistent with the Chicago Convention which states that international air transport services should be provided on the basis of equality of opportunity, as well as sound and economical operation¹⁴⁴.

Prior to the 1990s, the application of competition law amongst States was not widely practised, especially with regard to international air transport. Instead, States exercised heavy-handed regulation over international air transport to address competition issues¹⁴⁵. An example is the imposition of the double approval regime regarding airfare determination, aimed at addressing issues of predatory pricing or excessive pricing by airlines. Thus, traditionally, the ASAs do not contain provisions that prescribe for the application of competition laws. On the other hand, some ASAs include certain competition principles and commitments to prevent unfair practices.

However, as more States liberalise the international air transport and government involvement in the commercial operation of air transport lessens, the application of competition law/principles to govern such services becomes crucial to ensure fair competition. The liberalisation of international air transport would generally lead to increased competition between airlines for existing or new market shares, which may encourage airlines to consider consolidation as a means to maximise profits and increase their market shares. As such, it is important for States to enforce their competition laws to address potential anti-competitive behaviours by the industry players including airlines, airport operators, and ground-handling companies. For example, the enforcement of competition law on alliances and mergers would be of importance to ensure that such transactions do not hamper competition in a liberalised market.

At present, approximately 120 States have adopted competition laws within their respective legal systems. As States pursue further liberalisation in the international air transport, the application of competition laws to the sector has also gained wide acceptance by States.

The importance of fair competition in a liberalised market is also recognised by the EU in its bilateral arrangements with other States. In this regard, the EC is mandated to pursue ASAs with ASEAN, Qatar, the UAE, and Turkey to ensure fair competition in key international markets. Amongst others, the EU is negotiating for provisions that guarantee the effective application of competition law by the States and govern State subsidies to airlines. The level of commitments pursued by the EU in ongoing negotiations is comparable to those in free trade agreements, surpassing the standards contained in the ICAO Template ASA. Given the increasing prominence of competition law and policy issues in ASA negotiations, there is a need for States to better coordinate and formulate their positions regarding competition-related matters in ASAs.

¹⁴⁴ Preamble and Article 44 of the Chicago Convention.

¹⁴⁵ ICAO (2017).

Other than the application of antitrust laws and merger control, issues relating to subsidies have also been highlighted by States. The EU has been vocal in voicing its concerns relating to alleged subsidies by other States that distort competition to the detriment of EU carriers. In fact, the EU is currently developing new regulations to safeguard competition in air transport and address these issues.

In the case of Malaysia, Part VII of Act 771 contains competition law provisions that specifically govern aviation services in general, which includes international air services involving Malaysia. Part VII prohibits anti-competitive agreements, abuse of dominance, and mergers that lead to substantial lessening of competition in the aviation service market. However, the issue of subsidies in the context of competition is not currently governed by Act 771 or any other law. In light of the development of competition law in the increasingly liberalised aviation sector, the regulatory framework governing competition law for the sector would need to be reviewed periodically to keep abreast with the industry.

CONCLUSION

There are more than 2,900 bilateral ASAs worldwide. These ASAs define the commercial rights granted by the States to their airlines to fly over and within their territories, including on matters regarding ATRs and the airline nationality requirement. ASAs and these two specific elements are important factors that determine the openness of a State in terms of international air transport, which in turn, would affect the State's connectivity.

At present, more than 75% of bilateral ASAs worldwide are "traditional" ASAs, providing limited ATRs that are further regulated in terms of the determination of route, capacity, and airfare. However, following the first "open skies" agreement in 1992 (US-Netherlands), more States have sought for liberal ASAs which entail more extensive ATRs and the airlines' commercial freedom to exercise those rights, subject to competition law. Competition law's role in governing international air transport in a liberalised market is crucial to prevent or stop anti-competitive behaviours from hampering the competition process in the market.

Malaysia has entered into 106 bilateral ASAs, most of which are traditional ASAs. Malaysia's bilateral ASAs largely provide for third and fourth freedom rights, as well as limited fifth freedom right. However, Malaysian carriers are providing direct connections to 25 countries only, showing a low level of ATRs utilisation. This indicates a mismatch between market access and demand by airlines and consumers, the conclusion of ASAs to pursue general diplomatic objectives with certain countries instead of specific aviation interests or needs, as well as a reflection of Malaysian carriers' focus on serving more regional destinations. Conversely, Malaysian carriers are maximising their ATRs on certain routes with limited capacity such as the routes connecting to Nepal, Pakistan, and Tokyo Haneda International Airport. Also, a liberal ASA per se does not guarantee an increase in passenger traffic and competition between the Parties. Ultimately, the impact of a liberal ASA hinges on other factors such as the economic growth and activities of the States. As such, it is important for Malaysia to align its future ATR liberalisation strategies with its connectivity, trade, and tourism objectives.

Most ASAs require an airline to be substantially-owned and effectively-controlled by nationals of a Party in order for it to exercise rights under respective ASAs. Thus, a majority of States restrict foreign ownership and control in their airlines. Compared to ATRs, States are more reluctant to liberalise the airline nationality requirement due to economic, safety, and security concerns. A key development in this regard is the establishment of EU community carriers, which allows EU-based airlines to exercise unfettered ATRs on any route within the region.

The establishment of the ASEAN Single Aviation Market is an important development in the region, despite its implementation hiccups. At present, the MAAS, the MAFLPAS, and their protocols provide up to the intra-ASEAN fifth freedom and domestic code-share rights. The agreements also provide for the possibility of ASEAN community carriers in the future. ASEAN is also pursuing liberal ASAs with its Dialogue Partners, having entered into an ASA with China.

Based on the above, in developing Malaysia's future aviation policies, the liberalisation of ATRs and airline nationality requirement should be seriously considered for the purpose of further enhancing the development of its civil aviation industry and achieving the nation's connectivity and economic objectives.

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