

Foreign Direct Investment in ASEAN Airline Industry

Rio Christiawan^{1*}, Haris Zuan², Sufian Jusoh³, Ridha Aditya Nugraha⁴

¹ Faculty of Law, Universitas 17 Agustus 1945 Jakarta, Indonesia.

² Centre for Air Transport Management, Cranfield University, United Kingdom; Institute of Malaysian and International Studies (IKMAS), Universiti Kebangsaan Malaysia, Malaysia.

³ Institute of Malaysian and International Studies, Universiti Kebangsaan Malaysia, Malaysia.

⁴ Air and Space Law Studies – International Business Law Program, Universitas Prasetiya Mulya, Indonesia.

* Corresponding author: rio.christiawan@uta45jakarta.ac.id

Abstract: The development of aviation market in Southeast Asia after the Covid-19 pandemic is promising. More aircraft are delivered to the Asia-Pacific region, including the Association of South East Asian Nations (ASEAN) Member States. The introduction of ASEAN Open Skies (also known as ASEAN Single Aviation Market) a decade earlier together with ASEAN Economic Community Blueprint 2025 goals for an integrated and cohesive regional economy highlight the importance of a seamless air connectivity. Liberalisation of the airline industry in ASEAN Member States is crucial to restart the airline industry pre-pandemic and to grasp the so-called Asian century momentum. However, ASEAN Member States are reluctant towards liberalisation efforts, maintaining protectionism on both freedoms of the air (traffic rights) as well as foreign direct investment (ownership and control). Existing legal framework at regional level, namely ASEAN Framework Agreement on Services (AFAS) and ASEAN Trade in Services Agreement (ATISA), only received lukewarm attention from ASEAN Member States. This article discusses the urgency to recall the commitment of a gradual liberalisation based on AFAS and ATISA among the ASEAN Member States, the implementation of which will lead to the establishment of a regional community carrier which benefits ASEAN citizens.

Keywords: Air Law; Airline; ASEAN; Aviation Law; Investment; Foreign Direct Investment

1. Introduction

The year 2022 became the pivotal year in which the aviation industry started to revive post-Covid 19. Initiatives to speed up its recovery were brought up in national, regional, and global stages. The International Civil Aviation Organization (ICAO) established the Council's Aviation Recovery Task Force in providing guidance to governments and industry operators on a coordinated global basis.¹ As a United Nations specialized agency bearing autonomous international organization status, ICAO holds the advantage to lead such coordination among its 193 Member States.

¹ "Council Aviation Recovery Taskforce (CART)", International Civil Aviation Organization, accessed October 9, 2022, <https://www.icao.int/covid/cart/Pages/default.aspx>.

The successful effort of ICAO Council's Aviation Recovery Task Force and its Member States means speeding up the return of passenger traffic to the pre-pandemic numbers. The International Air Transport Association (IATA) predicts that air transport passenger will return to normal in 2024 following less travel restrictions since 2022.² The Asia-Pacific region is forecasted to fully recover only in 2025 as an impact of slow international traffic growth within the region.³ As of October 2023, the current concern is how long the Russia-Ukraine conflict might last— as it significantly determines aviation fuel price which in turn affects airline operation costs. The conflict also impacts the aircraft spare parts supply chain, hampering optimal maintenance, repair, and overhaul (MRO).⁴ The latter situation raises a potential threat to aviation safety which needs attention.

Nevertheless, the aviation industry is optimistic in facing the future. The Asia-Pacific region, with its demographic bonus and consistent growth of household income, is predicted to lead the aviation industry's growth for the next two decades.⁵ China and India will likely enter the top three nations with most air passengers worldwide around 2025.⁶ Such forecast on the region does not change much compared to pre-pandemic era. This situation provides opportunity for global aviation industry to look eastward.

Southeast Asia, a region also known as Association of Southeast Asian Nations (ASEAN), consists of 650 million people. The region is dynamic in terms of membership with Timor-Leste— which was recently admitted as the 11th ASEAN Member States.⁷ Air transportation play a significant role in the region as it does not share only land borders but also divided by sea, with two of its Member States, namely Indonesia and the Philippines, are archipelagic countries. A couple other ASEAN Member States with only one international airport, namely Brunei Darussalam and Singapore, also heavily rely on seamless air connectivity for its livelihood.

Before the pandemic, Indonesia and Vietnam are forecasted to become the top fastest-growing aviation market in the decade.⁸ Thailand is also forecasted to seize themselves in top ten aviation market in terms of passengers' volume between 2020-2030;⁹ as it

² "Air Passenger Numbers to Recover in 2024", International Air Transport Association, accessed October 9, 2022, <https://www.iata.org/en/pressroom/2022-releases/2022-03-01-01/>.

³ International Air Transport Association, "Air Passenger Numbers to Recover".

⁴ Wihana Kirana Jaya, "The Rise of the Aviation Industry", *Harian Kompas*, September 30, 2023, <https://www.kompas.id/baca/english/2023/09/29/en-kebangkitan-industri-penerbangan>.

⁵ "Global Outlook for Air Transport: Times of Turbulence (June 2022)", International Air Transport Association, accessed October 20, 2022, <https://www.iata.org/en/iata-repository/publications/economic-reports/airline-industry-economic-performance---june-2022---report/>.

⁶ Saurabh Sinha, "India to be world's third largest aviation market by 2024-25: IATA", *Times of India*, October 24, 2018, <https://timesofindia.indiatimes.com/business/india-business/india-to-be-worlds-third-largest-aviation-market-by-2024-25-iata/articleshow/66351652.cms>.

⁷ "ASEAN Leaders' Statement on the Application of Timor-Leste for ASEAN Membership", ASEAN Secretariat, accessed September 30, 2023, <https://asean.org/wp-content/uploads/2022/11/05-ASEAN-Leaders-Statement-on-the-Application-of-Timor-Leste-for-ASEAN-Membership.pdf>.

⁸ "IATA Forecasts Passenger Demand to Double Over 20 Years", International Air Transport Association, accessed October 20, 2022, <https://www.iata.org/en/pressroom/pr/2016-10-18-02/>.

⁹ "IATA Forecast Predicts 8.2 billion Air Travelers in 2037", International Air Transport Association, accessed October 20, 2022, <https://www.iata.org/en/pressroom/pr/2018-10-24-02/>.

was the leading ASEAN Member States in importing foreign tourists and served as an important hub in Asia-Pacific prior to the pandemic. A promising opportunity and growth prospects with economic benefits driven by air transportation; but one that could be jeopardized if severe protectionist measures are implemented through regional or national legal framework.¹⁰

To ensure airlines are able to offer services – more in terms of fleet readiness and routes availability – similar or better than the pre-pandemic market, many airlines in the ASEAN region require capital injections to restart. These capital injections could come from the existing shareholders, and critically also from foreign direct investments (FDI). Hence, FDI liberalisation pertaining to airline industry becomes an essential tool in seizing post-pandemic recovery momentum. The industry in ASEAN is identical with high barrier to overcome – among others high capital and protectionism. As Richard Branson having once said, launching a new airline with one billion dollars is the way to become a millionaire.¹¹ In fact, not all ASEAN Member States' airlines – either state-owned or private – have sufficient equity. Consolidation through liberalisation is one of the realistic paths to seize the momentum and to ensure aviation industry sustainability in the region.

This article addresses the urgency to recall the commitment of a gradual liberalisation based on AFAS and ATISA among the ASEAN Member States. Its implementation will lead to a new chapter of establishing a regional community carrier which benefits ASEAN citizens. Furthermore, the importance of ASEAN air transportation sector cannot be overstated as the pendulum of economic growth in the 21st century has shifted to Asia. This research, written from the ASEAN perspective, aims to provide a better understanding on current situation in the region.

2. ASEAN Aviation Investment Regime

Under the ASEAN Economic Community Blueprint 2025¹², ASEAN plans to become a highly integrated and cohesive regional economy that supports sustained high economic growth. The intent is achievable through increasing trade, investment, and job creation; improving regional capacity to respond to global challenges and mega trends; deeper integration in trade and services; and a more seamless movement of investment, skilled labour, business persons, and capital. To achieve the 2025 dream, ASEAN must increase connectivity between ASEAN Member States. One of the tools to boost connectivity is through the aviation sector.

In order to support the integration and development of the ASEAN Economic Community, ASEAN introduced an initiative to establish the ASEAN Single Aviation Market (ASAM) by 2015, at the 13th ASEAN leader's summit in 2007. ASEAN intends to utilise ASAM as a tool to improve the overall performance of the region air transport

¹⁰ Ruwantissa Abeyratne, *Aeronomics and Law: Fixing Anomalies*, (Berlin: Springer-Verlag Berlin Heidelberg, 2012), 17.

¹¹ "Who Wants to be a Millionaire?", *Forbes*, accessed February 27, 2024, <https://www.forbes.com/sites/jamescahn/2017/02/07/who-wants-to-be-a-millionaire/?sh=3b0aba9a5aaa>.

¹² The ASEAN Economic Community Blueprint 2025 was adopted by ASEAN Leaders at the 27th ASEAN Summit on 22 November 2015 in Kuala Lumpur, Malaysia.

sector. ASAM will focus more on a common and co-ordinated approach to aviation safety, aviation security, and air traffic management by removing domestic restrictions in each ASEAN Member State's markets to achieve open skies.¹³

There are two typical restrictions in air transportation, namely i.) market access (rights to freedom of the air) and ii.) ownership and control. Deregulation and liberalisation seek to limit or even, in some instances, eliminate these restrictions. Relaxation of market access restrictions granted the rights for foreign airlines to operate in other domestic markets; while ownership and control refers to foreign equity participation in national airlines.¹⁴

The issue of ownership and control in the aviation sector in ASEAN falls within the scope of services sector regulations. The main agreements governing ownership and control in the aviation sector is the ASEAN Framework Agreement on Services (AFAS), which is being replaced by the ASEAN Trade in Services Agreement (ATISA)¹⁵. AFAS was signed in 1995, and the various rounds of negotiations took place under AFAS to liberalise intra-regional services trade. Up until now, ten packages of commitments have been concluded. Financial services and air transport services were previously included in the AFAS negotiations but later negotiated separately into independent packages. Since then, the 10th package of AFAS, 8th package of financial services, and 11th package of air transport services have all been integrated into AFAS -- and now ATISA.¹⁶

ATISA was finalised and signed by the ASEAN Member States on 7 October 2020. It will supersede AFAS and all its protocols. It sets out to review existing flexibilities, limitations, thresholds and carve-outs; enhance mechanisms to attract FDI in the services sectors to support GVC activities; allow further liberalisation; establish possible disciplines on domestic regulations to ensure competitiveness of the services sector, taking into consideration other non-economic or development or regulatory objectives; consider the development of sectoral annexes; and enhance technical cooperation in the services sector for human resource development, joint promotion activities to attract FDI in the services sector, and the exchange of best practices.¹⁷ There are three annexes, namely i.) Annex on Financial Services, ii.) Annex on Telecommunication Services, and iii.) Annex on Air Transport Ancillary Services.¹⁸

ATISA deviates from AFAS by requiring ASEAN Member States to adopt a negative list approach, and includes regulatory cooperation between ASEAN Member States.¹⁹ ASEAN Member States are required to submit their Schedule of Non-Conforming

¹³ An open skies concept means freedom of air traffic rights and also more freedom to business practices which are normally restricted, namely i.) flight frequency and capacity; ii.) fare or tariff; iii.) aircraft type in service; iv.) designated airline(s); and v.) designated route(s). See Brian F. Havel, *Beyond Open Skies: A New Regime for International Aviation* (Alphen aan den Rijn: Kluwer Law International, 2009).

¹⁴ Ruwantissa Abeyratne, *Aeronomics and Law*, 17-19.

¹⁵ Signed by all (ten) ASEAN Member States in October 2020.

¹⁶ Meeryung La, "ASEAN Economic Integration on Services: An Analysis of Economic Impacts and Implications", *World Economy Brief* Vol. 11 No. 29 (May 2021): 2.

¹⁷ "ASEAN Signs Trade in Services Agreement", ASEAN Secretariat, accessed March 6, 2024, <https://asean.org/asean-signs-trade-in-services-agreement/>.

¹⁸ "ASEAN Signs Trade in Services Agreement", ASEAN Secretariat.

¹⁹ Meeryung La, "ASEAN Economic Integration on Services", 2.

Measures by 5 April 2026, within five years of ATISA coming into force;²⁰ with the exception of Vietnam (7 years) and Cambodia, Lao PDR and Myanmar (13 years).²¹ Pending the submission of the Non-Conforming Measures, the positive list Schedules of Commitments made under AFAS still stand -- the latest being the 10th package, 7th package under the financial services, and 9th package under the packages of air transport services.

For the first type of liberalisation, ASEAN has concluded various measures to integrate and liberalise the aviation sector since 2004. In the implementation of ASAM, ASEAN has introduced market access liberalisation through three multilateral agreements, namely i.) Multilateral Agreement on Air Services of 2009 (MAAS); ii.) Multilateral Agreement for the Full Liberalisation of Air Freight Services of 2009 (MAFLAFS); and iii.) Multilateral Agreement for the Full Liberalisation of Passenger Air Services of 2010 (MAFLPAS). Due to concerns of its national airlines losing market share, a few ASEAN Member States were reluctant to sign the three multilateral agreements, which delayed the plan.²² Finally on 7 April 2016, Indonesia became the last ASEAN Member States to sign the latest unratified instrument, namely MAFLPLAS, which led to the full enactment of ASEAN Single Aviation Market.

Under the AFAS 10th package, ASEAN Member States make the following commitments:

MAAS, MAFLPAS, MAFLFAS: Each contracting party shall have the right to designate as many airlines as it wishes for the purpose of conducting international air freight/passenger services in according with the agreement [...] On the receipt of such designation, and of application from the designated airline [...] each contracting party shall grant the appropriate authorisation and technical permission with minimum procedural delay, provided that: [...] subject to the acceptance of the contracting party receiving the application of a designated airline, the designated airline is incorporated in and has its principal place of business in the territory of the contracting party, and is and remains substantially owned and effectively controlled by one or more ASEAN Member State and/or its nationals, and the designating State has and maintains effective regulatory control [...]. [domestic air transport not covered].²³

Under the second type of liberalisation, ASEAN Member States may undertake liberalisation of the aviation sector through both the AFAS and later ATISA. In addition, the ASEAN Comprehensive Investment Agreement of 2009²⁴ will provide guarantees on

²⁰ "2020 ASEAN Trade in Services Agreement", conclusion date October 7, 2020, <https://agreement.asean.org/media/download/20201111041414.pdf>, 17–18.

²¹ ASEAN Trade in Services Agreement, 17–18.

²² Ridha Aditya Nugraha, "The Indonesian Aviation Sector in the Realm of Liberalisation: The Long and Winding Road", in *Aviation Law and Policy in Asia: Smart Regulation in Liberalized Markets*, ed. Jae Woon Lee (Leiden: Brill Nijhoff, 2020), 255-257.

²³ The initiative of AFAS 10th package has started a decade earlier, namely through i.) Multilateral Agreement on Air Services of 2009 (MAAS), art. 3; ii.) Multilateral Agreement for the Full Liberalisation of Air Freight Services of 2009 (MAFLAFS), art. 3; and iii.) Multilateral Agreement for the Full Liberalisation of Passenger Air Services of 2010 (MAFLPAS), art. 3.

²⁴ Came into force on 29 March 2012. Followed with Protocol to Amend the ASEAN Comprehensive Investment Agreement of 2014.

investment facilitation and investment protections to ASEAN investors investing in the aviation sector in another ASEAN Member States.²⁵

However, commitments made under the AFAS 10th package are meaningless as it does not specify the limits imposed by each ASEAN Member State's air transport or aviation law on the issuance of air operator's certificate (AOC). Many ASEAN Member States do not make any clear commitments to the liberalisation of ownership and control. Some ASEAN Member States make commitments based on their existing domestic regulations.²⁶ Being 'unbound' means the relevant ASEAN Member State backtracks from the existing domestic regulations and imposes more restrictive measures.

Table 1. FDI Restrictions on Airline Sector in ASEAN Member States²⁷

ASEAN Member States	Ownership Restrictions in Commercial Presence (Mode 3) (AFAS 10 th Package)	Existing Domestic Regulations
Brunei Darussalam	No commitment.	49% foreign ownership maximum.
Cambodia	No commitment.	100% foreign ownership allowed.
Indonesia	Maximum foreign equity of 49%.	49% foreign ownership maximum. There should be a single majority Indonesian shareholder. The human resource director should be Indonesian.
Lao PDR	Up to 100% foreign ownership.	100% foreign ownership allowed. In a joint venture scheme, foreign investors shall contribute minimum 10% of the total equity.
Malaysia	No limitation on market access. The national treatment commitment as provided by AFAS.	45% foreign ownership maximum only for Malaysia Airlines as the flag carrier. Maximum ownership of a single foreign entity is limited to 20%. While 49% foreign ownership maximum for other (private) airlines.
Myanmar	No clear commitments.	100% foreign ownership allowed.
Philippines	No commitments.	40% foreign ownership maximum.
Singapore	Unbound but with foreign equity participation up to 70%.	49% foreign ownership maximum.
Thailand	Maximum foreign equity of 49%.	49% foreign ownership maximum.
Vietnam	No limitation on market access. No limitation on national treatment commitment.	49% foreign registered capital maximum. No single individual or legal entity shall hold more than 30% of registered capital.

²⁵ Johan, Suwinto, Amad Sudiro, and Ariawan Gunadi. "What Could ASEAN Learn about Bankruptcy Law from ASEAN Partner Countries, China and Japan?." *Hasanuddin Law Review* 8, no. 3 (2022): 194-210.

²⁶ "ASEAN Prosperity Initiative 2020 Briefing Paper No. 02 – ASEAN Integration Through The Skies: The Current Progress In Preparation for 2025", ASEAN Prosperity Initiative, accessed October 7, 2023, <https://www.aseanprosperity.org/publications/research-papers/api-2020-briefing-paper-no-02-asean-integration-through-the-skies-the-current-progress-in-preparation-for-2025/>.

²⁷ Compilation of ASEAN Member States national legislations on aviation and investment in 2023. Currently Timor-Leste is in the progress of full integration and harmonization with existing ASEAN legal framework, thus excluded from Table 1. See also Sufian Jusoh, "Integrating ASEAN Economy through Liberalisation of Investment in the Aviation Sector", *ASEAN Aviation Integration Platform (AAIP) IKMAS Universiti Kebangsaan Malaysia*, accessed October 7, 2023, https://www.ukm.my/aaip/wp-content/uploads/2019/03/AAIP-Policy-Paper-No.-1_2018-Integrating-ASEAN-Economy-Through-Liberalisation-of-Investment-in-the-Aviation-Sector.pdf.

3. Liberalisation Progress in ASEAN Member States

Both MAAS and MAFLPAS are fundamental instruments which set out separate liberalisation schedules for capital and non-capital points in the region. These two instruments are important in the establishment of the 'ASEAN community carrier' concept which allows airlines to be substantially owned and effectively controlled by ASEAN Member States.²⁸ Article 3(2)(a) MAAS has laid the foundation for such community carrier establishment. However, in reality its implementation is halted since the article remains subject to respective ASEAN Member States consent based on application. Furthermore, when referring to Table 1, it is clear that each ASEAN Member State has implemented the road map (AFAS 10th Package – Mode 3) at a different pace and to varying degrees.

A few ASEAN Member States concluded multilateral air service agreements among themselves to relax market access restrictions without waiting for other ASEAN Members States to do so. In fact, Brunei Darussalam, Singapore and Thailand adopted limited air service agreements among themselves in 2004, way ahead of the official timeline set out by the wider bloc.²⁹ But Indonesia – ASEAN's largest economy and domestic air transportation market with around 90 million passengers annually pre-Covid 19 – only ratified the agreements in April 2016. Reluctant towards new level playing field is one of the main reasons behind such tardiness in implementing ASEAN Single Aviation Market target in 2015. By the end of December 2022, Indonesia has yet to ratify AFAS as well.

Some ASEAN Member States have more liberal air services agreements with the third countries than among themselves. With the United States, Brunei Darussalam, Indonesia, Malaysia, Singapore, Thailand, and Lao PDR have open skies agreements that allow, at the minimum, unlimited third and fourth freedom of the air rights. Moreover, Brunei Darussalam and Singapore have gone further with the United States in that they are state parties to the Asia-Pacific Economic Cooperation (APEC) sponsored Multilateral Agreement on the Liberalization of International Air Transportation of 2001 (MALIAT)³⁰ along with its protocol.

The MALIAT provides for unlimited third, fourth, and fifth freedom of the air rights among the state parties and replaces the traditional "substantial ownership and effective control requirement" with a more progressive "principal place of business and incorporation as well as effective control" clause.³¹ Both ASEAN Member States - Brunei Darussalam and Singapore - are also party to the MALIAT protocol, which goes further

²⁸ Alan Khee-Jin Tan, "Aviation Policy in the Philippines and the Impact of the Proposed Southeast Asian Single Aviation Market", *Air and Space Law* Vol. 34 No. 4/5 (2009): 302-303.

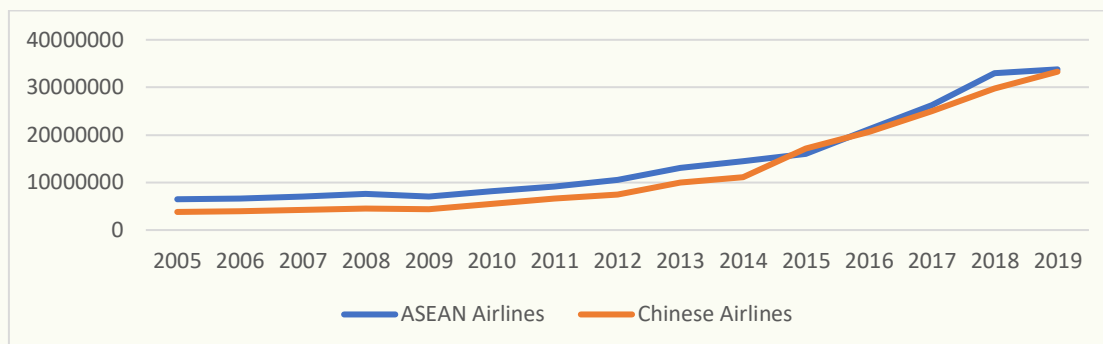
²⁹ Haris Zuan, D. Ellis, and R. Pagliari, "Geopolitics and the ASEAN Single Aviation Market: Aspirations versus Realities", *Transportation Research Procedia* Vol. 59 (2021): 95-104.

³⁰ Signed on 1 May 2001 in Washington. The five signatories of Multilateral Agreement of the Liberalization of International Air Transportation of 2001 are Brunei Darussalam, Chile, New Zealand, Singapore, and United States of America. As of 2023, the multilateral agreement is enacted in nine state parties, namely Brunei Darussalam, Chile, Cook Islands, Mongolia, New Zealand, Samoa, Singapore, Tonga, and the United States of America. Two state parties withdrew in 2005 (Peru) and 2019 (Samoa).

³¹ "Multilateral Agreement of the Liberalization of International Air Transportation of 2001", conclusion date May 1, 2001, <https://2009-2017.state.gov/e/eb/rls/othr/ata/114302.htm>.

in providing for the exchange of seventh freedom of the air and cabotage rights. While the impact of MALIAT and its protocol is limited due to the very few state parties that they have managed to attract, the involvement of Brunei Darussalam and Singapore shows that ASEAN Member States do in some respects go further with their trading partners than among themselves.

Figure 1. Number of Seats by Airline Origin on Routes between ASEAN Member States and China 2005-2019³²



Back in 2010, ASEAN and China signed an air transport agreement to establish liberalised market access for both sides' airlines.³³ ASEAN-Chinese market benefits both airlines from China and ASEAN Member States, although, in the beginning, there was concern about imbalances in traffic rights.³⁴ Considering the vast market potential, between 2010-2015, the ASEAN-China market attracted more new airlines to operate. There were eight Chinese airlines and four Thai airlines, one each from Vietnam and Singapore involved.³⁵ This development made China a vital external factor in the success of ASEAN Single Aviation Market (also known as ASEAN Open Skies).

In addition, several ASEAN Member States have entered into horizontal agreements with the European Community that recognize the right of all European Union (EU) Community carriers³⁶ to operate between any EU point and the state concerned. As of October 2013, four ASEAN member states - Singapore, Malaysia, Indonesia, and

³² Author analysis based on OAG Aviation data set.

³³ Air Transport Agreement between the Governments of the Member States of the Association of Southeast Asian Nations and the Government of the People's Republic of China. Adopted on 12 November 2010. Fifth freedom of the air traffic rights between China and all ASEAN Member States have taken place effectively since 2019.

³⁴ The concern was based on the fact that the benefits from the agreement are not balanced, with China gaining more access than ASEAN Member States. In practice, ASEAN has not yet operated as a real single market which causes aero-political imbalance in the agreement. ASEAN Member States' airlines can only connect from their home country to China, but not from points in other ASEAN countries to China (forbidding seventh freedom of the air); while Chinese airlines can effectively connect any point in China with any point in any ASEAN Member States. See Alan Khee-Jin Tan, "The 2010 ASEAN-China Air Transport Agreement: Placing the Cart before the Horse?", *Air and Space Law* Vol. 37 No. 1 (2012): 35-42. See Isabelle Laplace, Nathalie Lenoir, and Chantal Roucolle, "Economic Impacts of the ASEAN Single Aviation Market: Focus on Cambodia, Laos, Myanmar, The Philippines and Vietnam", *Asia Pacific Business Review*, Vol. 25 No. 5 (2019): 656-682.

³⁵ Nathalie Lenoir and Isabelle Laplace, "Liberalization in Southeast Asia: Who is Capturing the Markets?", *World Conference on Transport Research* 2016 (July 2016): 3-11.

³⁶ EU Community carrier refers to an airline with an operating license issued by an EU Member State in accordance with Regulation (EC) No. 1008/2008 on Common Rules for the Operation of Air Services in the Community. See Chapter II pertaining to operating license.

Vietnam - have entered into horizontal agreements with the European Community and their individual bilateral agreements with the EU members do go much further. For instance, Singapore has had an extremely liberal agreement with the United Kingdom since 2007 that provides for unlimited third, fourth, fifth, and even seventh freedom of the air rights; as well as domestic carriage rights for both sides' carriers. In June 2013, Malaysia adopted a new agreement with the United Kingdom containing similar rights.³⁷

In 2022, ASEAN-EU signed the world's first bloc-to-bloc aviation pact to boost air connectivity between regions.³⁸ Ratification process is undergoing according to each Member State's procedural law. It replaces more than 140 bilateral air services agreements, thereby providing a single set of rules and reducing red tape. EU Member States without any bilateral agreements with ASEAN Member States are now also protected by a modern legal framework. All EU airlines will be able to operate direct flights from any airport in EU to all airports in ASEAN Member States, and vice versa for ASEAN airlines. The new level playing field will help EU and ASEAN airlines compete with competitors targeting the lucrative EU-ASEAN market.

Both regions' airlines will be able to fly up to 14 weekly passenger services to or from each EU Member State, and any number of cargo services through and beyond both territories, to any third country (utilizing fifth freedom of the air rights). The agreement includes modern and fair competition provisions to address market distortions. However, the initial impact is likely to be small, due to the limited number of connecting flights to third countries that can be operated on the new routes, limited available slots at European airports, and the intense competition posed by Middle Eastern airlines.³⁹

Nevertheless, regional integration appears incomplete in certain key respects. To achieve a truly integrated aviation market, further liberalisation, such as the seventh freedom of the air (the right to fly between two ASEAN Member States while not offering flights to one's own country); eighth freedom of the air (the right to fly between two or more airports within an ASEAN Member States while continuing service to one's own country); and ninth freedom of the air (the right to fly inside an ASEAN Member State without continuing service to one's own country) are all necessary. A single aviation market such as that which exists in the EU liberalises such operations fully and allows market competition throughout the region. But in ASEAN, domestic airlines remain highly sensitive for large countries with a huge domestic population.⁴⁰ Typically, such operations are reserved exclusively for local players, and most ASEAN Member States uphold that *status quo*.

³⁷ "Air Services Agreements: Air Traffic Rights and Airline Nationality Requirement", Malaysian Aviation Commission (November 2018), accessed March 3, 2024, <https://www.mavcom.my/wp-content/uploads/2018/11/Technical-Paper-Air-Services-Agreement-November-2018.pdf>.

³⁸ "Aviation: Landmark EU-ASEAN agreement to connect 1.1 billion people", European Commission, accessed October 7, 2023, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6126.

³⁹ "ASEAN and the EU Sign the World's First Bloc-to-Bloc Air Transport Agreement", European Union External Action (November 17, 2022), accessed March 3, 2024, https://www.eeas.europa.eu/delegations/association-southeast-asian-nations-asean/asean-and-eu-sign-world's-first-bloc-bloc-air-transport-agreement_en.

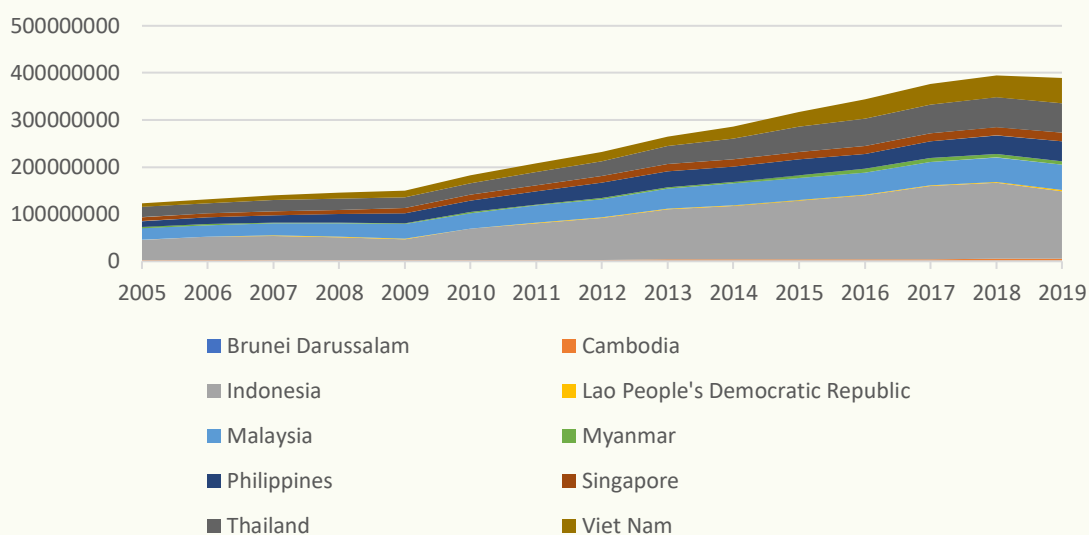
⁴⁰ Ridha Aditya Nugraha, "ASEAN Prosperity Initiative 2020 Briefing Paper No. 02".

Finally, as far as ownership and control is concerned, although in theory a "community carrier" is allowed to operate, in practice, it is still difficult. There is no certainty that the "community carrier" can fly into all ASEAN Member States, as the Member States still need to provide an approval before the carrier can operate. Unless a significant number of ASEAN Member States first declare their unequivocal approval for such a model, the current uncertainty can discourage any investor thinking of establishing such an airline. For now, investors in ASEAN comply with the traditional "substantial ownership and effective control of nationals" rule.

3.1. ASEAN Open Skies Recent Developments

Although there are no significant achievements in terms of ownership and control, ASEAN Open Skies has helped boost the air transport market in Southeast Asia. Figure 2 below illustrates the development of the air transport market in ASEAN Member States based on the number of seats from 2005 to 2019.

Figure 2. Total Seats Across ASEAN by Origin of Departure 2005-2019⁴¹



The number of seats only increased by 20% from 126.8 million in 2005 to 152.2 million in 2009. With the introduction of ASEAN Single Aviation Market, seats increased by 17% within a year in 2010. In 2018, the number of seats increased by 68% to 397.1 million compared to 2005 – although there was a slight cutback in 2019 compared to the previous year due to the China-United States trade war; which affected not only the Southeast Asian market but also Europe.⁴² Yet, in less than 20 years, the number of seats offered in Southeast Asia has tripled. The exponential growth in air transport

⁴¹ Compilation from ASEAN Secretariat data in 2023.

⁴² "How would a global trade war affect aviation? Air passenger and freight both at risk from escalation in tariffs", International Air Transport Association, accessed October 5, 2023, <https://www.iata.org/en/iata-repository/publications/economic-reports/how-would-a-global-trade-war-affect-aviation/>.

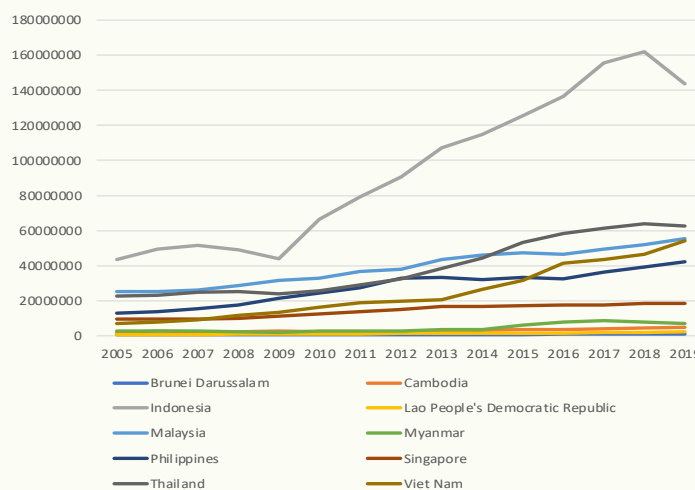
makes Southeast Asia one of the most vibrant emerging markets in the world, where it made up around 11% of the total global air transport market in 2019.⁴³

Indonesia has consistently contributed toward 34% and 40% of the total seats, with a 370% increase from 2005 to 2018 – the highest jump compared to other ASEAN Member States. Figure 2 shows that Indonesia is a very significant air transport market in Southeast Asia in terms of size. However, there was a considerable contraction of the domestic air market in 2019 due to a shift in Indonesian air transport policy that revised the floor and ceiling prices, resulting in higher domestic airfare.⁴⁴

Thailand saw a significant increase in seats due to the proliferation of joint-venture low-cost airlines in the country's air market. This continuous increase caused Thailand to surpass Malaysia in seats from 2015, allowing Thailand to emerge as the second-largest market in Southeast Asia after Indonesia. Another important air transport market is Vietnam which has seen significant growth because of the country's economic development in the last 20 years. Vietnam, the fastest-growing economy in Asia, recorded a significant increase in seats – and is now the third largest contributor after Indonesia and Thailand.

Low-cost carrier's (LCC – or low-fare airline) strategy to set up cross-broader joint-venture airlines managed to manoeuvre the substantial ownership and effective control to operate in the ASEAN Member State's domestic market. The LCCs are granted access rights to many international routes – including important routes traditionally monopolised by flag carriers. This rising trend is partly contributed by the emergence of LCCs in the Southeast Asian market in the early 2000s, which then rapidly boosted after the ratification of ASEAN Single Aviation Market or ASEAN Open Skies.

Figure 3. Total Seats by ASEAN Member States by Origin of Departure 2005-2019⁴⁵

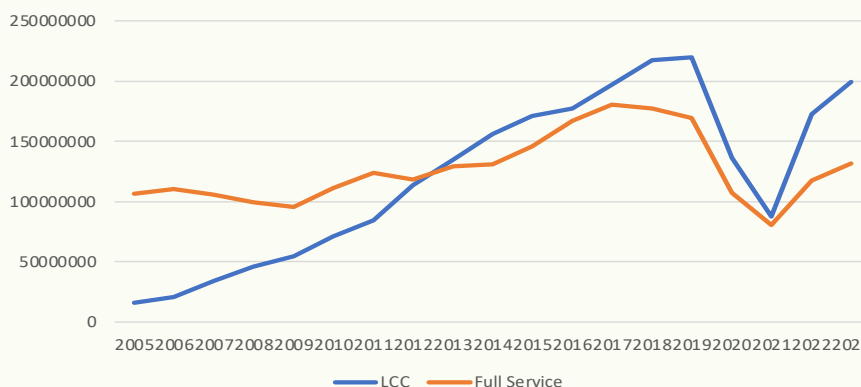


⁴³ “Landscape Study on Southeast Asia’s Aviation Industry: Covid-19 Impact and Post-Pandemic Strategy (May 2023)”, Asian Development Bank, accessed October 7, 2023, <https://www.adb.org/sites/default/files/publication/879966/southeast-asia-aviation-covid19-post-pandemic-strategy.pdf>.

⁴⁴ Ridha Aditya Nugraha, “The Long and Winding Road”, 259-264.

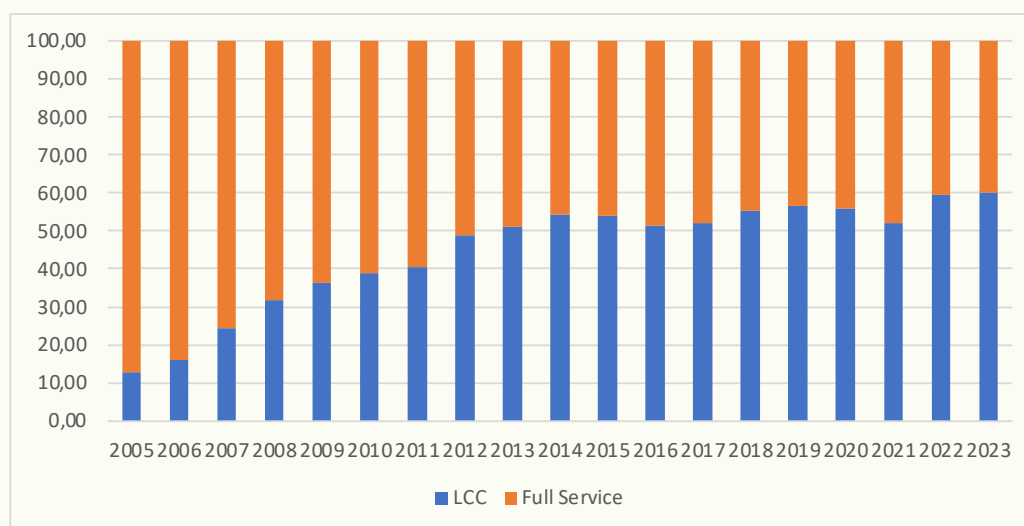
⁴⁵ Author analysis based on OAG Aviation data set in 2023.

Figure 4. ASEAN Market Share: LCC vs Full-Service Carrier by Number of Seats (2005-2023)⁴⁶



As a response to the domination of ‘independent LCCs’, such as AirAsia (Malaysia) and Lion Air (Indonesia), flag carriers or full-service-carriers are implementing dual-brand strategy by setting up their subsidiaries or own partial LCCs, such as Scoot by Singapore Airlines, Firefly by Malaysia Airlines, and Citilink by Garuda Indonesia.⁴⁷ The dual-brand strategy contributes to a more significant market share of LCCs in the region, as shown in Figure 5 below. In 2005, LCCs only controlled 13% of the Southeast Asian market before increasing to 39% in 2010. In 2013, LCCs surpassed the flag carriers' market share; and in 2023, LCCs market accounted for 60% of the total market.

Figure 5. ASEAN Market Share: Low-Cost Carrier vs Full-Service Carrier by Percentage of Seats (2005-2023)⁴⁸



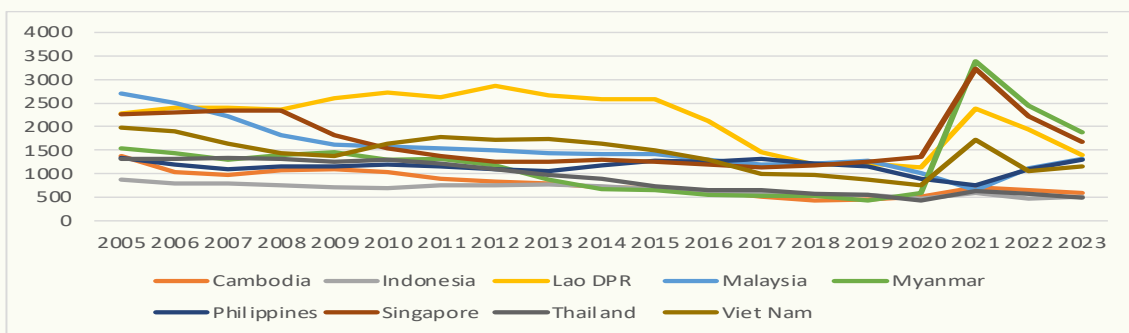
⁴⁶ Author analysis based on OAG Aviation data set in 2023.

⁴⁷ “Airline dual brand strategies: In search of the global panacea for LCC and Gulf airline competition”, Center for Asia Pacific Aviation, accessed October 5, 2023, <https://centreforaviation.com/analysis/reports/airline-dual-brand-strategies-in-search-of-the-global-panacea-for-lcc-and-gulf-airline-competition-251802>. See also “Vietnam Airlines clarifies its dual brand strategy and accelerates Jetstar Pacific’s expansion”, Center for Asia Pacific Aviation, accessed October 5, 2023, <https://centreforaviation.com/analysis/reports/vietnam-airlines-clarifies-its-dual-brand-strategy-and-accelerates-jetstar-pacifics-expansion-251827>.

⁴⁸ Author analysis based on OAG Aviation data set in 2023.

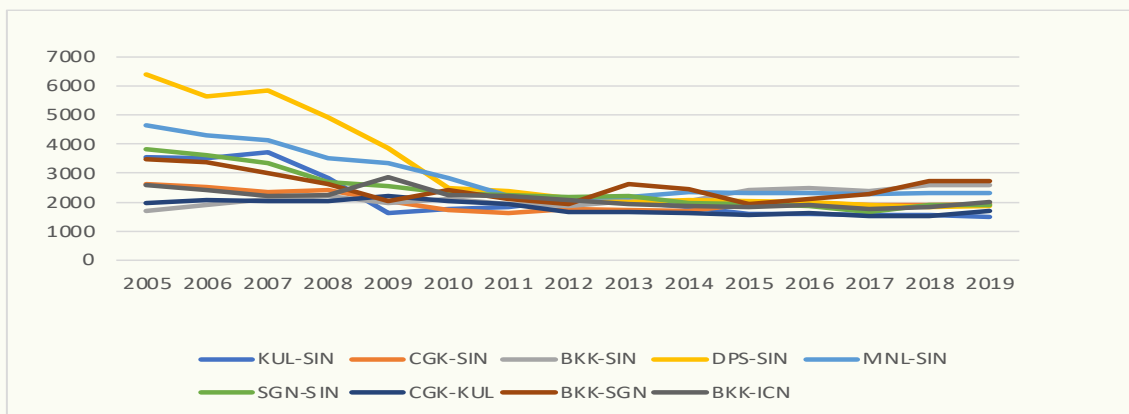
A question raised is whether the proliferation of the air market in Southeast Asia make it more competitive. While there are indications that the air market in Southeast Asia is becoming more competitive with the participation of more airlines, it does not mean the market pertaining to is now highly liberalised and unconcentrated. The air market in Southeast Asia is still witnessing high market concentration, especially in the domestic market. However, the situation is better in terms of the international or intra-ASEAN market. This situation can be explained through HHI's analysis⁴⁹ of the Southeast Asian air market. After the implementation of ASEAN Single Aviation Market, the regional initiative made steady overall progress in increasing market competition by liberalising international routes traditionally dominated by flag carriers until Covid-19 disruptions.

Figure 6. HHI in ASEAN Member States (2005-2023)⁵⁰



Furthermore, closer analysis on the top ten of the busiest routes in ASEAN revealed that all of the routes become highly competitive. Figure 7 below shows the progress since 2005.

Figure 7. HHI of Top Ten ASEAN International Routes (2005-2023)⁵¹



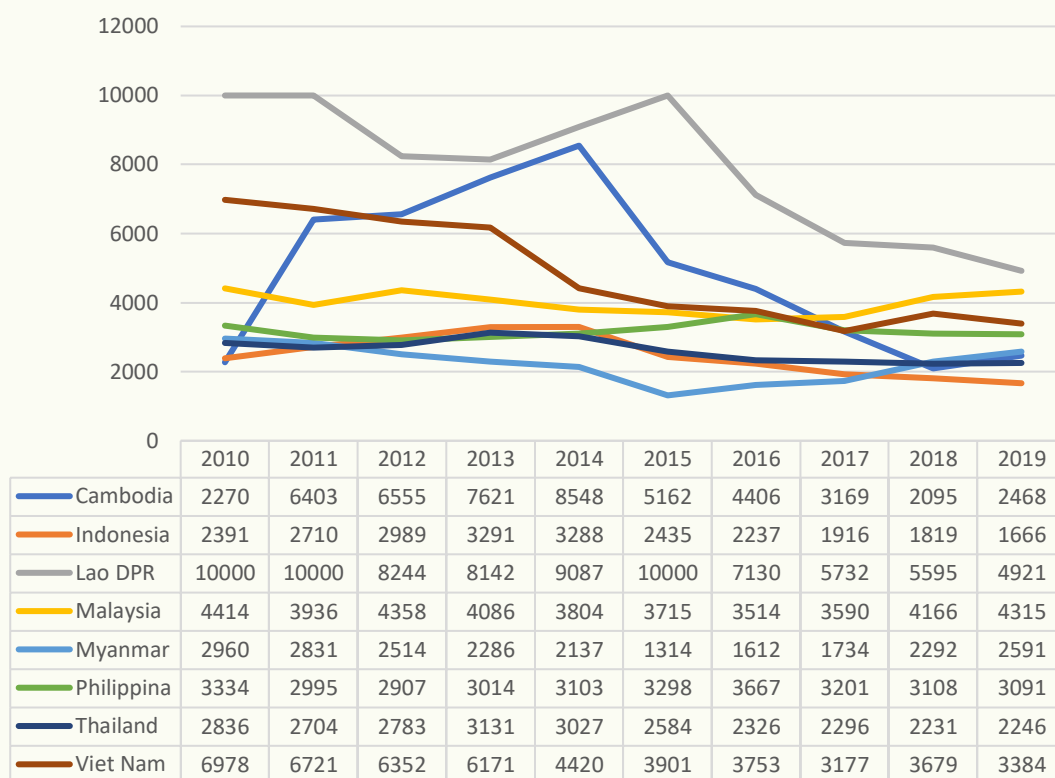
⁴⁹ Herfindahl-Hirschman Index (HHI) is commonly accepted market concentration measure (United States Department of Justice, 2018). HHI is an index to demonstrate the quadratic sum of each airline's market share compared to the total market size. The HHI ranges from 1 (least concentrated) to 10,000 (most concentrated). It is commonly accepted that HHI of less than 1,500 represents a low market concentration industry while 1,500–2,500 represents moderate concentration and more than 2,500 for a highly concentrated industry. See I-Chin Peng and Hua-An Lu, "Cooperation effects among global airline alliances for selected Asian airports", *Journal of Air Transport Management* Vol. 101 (June 2022).

⁵⁰ Author analysis based on OAG Aviation data set in 2023.

⁵¹ Author analysis based on OAG Aviation data set in 2023.

Overall, each of the ASEAN Member States' domestic air market is still dominated by several major players. None of the domestic air markets are below 1,500 points, but there has been a decrease in concentration from an average of 4,400 points in 2010 to 3,000 points in 2019. Lao PDR is the most concentrated market because its small market size is not economically viable for competition. Thailand is most open to competition domestic market, with the only market in the range between 1,500-2,500 - a moderately concentrated category.

Figure 8. HHI of ASEAN Member States Domestic Air Transport (2010-2019)⁵²



At a glance, Indonesia's HHI shows that its domestic air market is becoming more competitive with the increasingly intense competition when Indonesia's HHI score is relatively lower than some large Southeast Asian markets. At the same time, Indonesia's HHI also shows a downward trend. However, the fact is Indonesia's domestic market suffers from a duopoly.

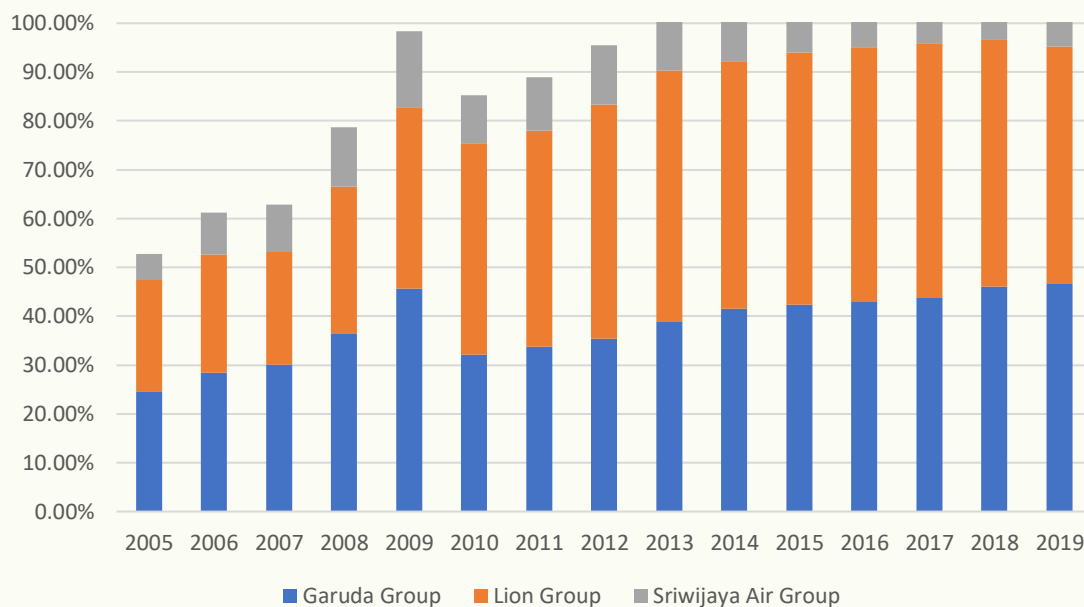
As a result of democratisation and to comply with International Monetary Fund (IMF) regulations, Indonesia passed Law No. 5 of 1999 on Prohibition of Monopolistic Practices and Unfair Business Competition which has affected the deregulation of airlines. Thus, since 2000, Indonesia's air market has shown more airline participations. No less than 20 airlines filled the competition in various classes. However, most existing airlines are not able to survive long, either because they are involved in numerous accidents and/or incidents that damage the entire company; or because of financial

⁵² Author analysis based on OAG Aviation data set in 2023.

inadequacies. In the end, only eight airlines ended up operating in the domestic market.⁵³

Lion Air initiated its operations in 2000 and introduced its low-cost regional subsidiary, Wings Air, in 2003. In 2013, the airline expanded by launching a full-service carrier, Batik Air. By 2017, the Lion Group had secured half of Indonesia's domestic market share. In comparison, the Garuda Indonesia Group (Garuda Airline and its LCC subsidiaries, Citilink) held a 30% to 40% share; while the Sriwijaya Air Group (Sriwijaya and Nam Air) held 10% to 20% of the domestic air market. The only Indonesian airlines with FDI, namely Indonesia AirAsia which primarily targets the international market, held a share of less than 2%.⁵⁴ Various small independent regional airlines collectively accounted for approximately 2%.

Figure 9. Indonesia Domestic Air Transport Market Share (2010-2019)⁵⁵



In 2018, Garuda Indonesia Group announced the establishment of a joint operation agreement involving Citilink, Garuda Indonesia, Sriwijaya Air, and Nam Air. Under this agreement, Garuda Indonesia Group (through Citilink) assumed the operational management responsibility for Sriwijaya Air and Nam Air, including financial management. Consequently, the agreement resulted in a remarkable consolidation of 96% of Indonesia's domestic market under the control of only two airline groups – namely Garuda Indonesia Group and Lion Group. Such dominance in domestic market is

⁵³ Ridha Aditya Nugraha, “Reviewing Ownership and Control of the Indonesian Airlines”, ASEAN Aviation Integration Platform (AAIP) IKMAS Universiti Kebangsaan Malaysia, accessed October 7, 2023, https://www.ukm.my/aaip/wp-content/uploads/2019/03/AAIP-Policy-Paper-No.-2_2019-Reviewing-Ownership-and-Control-of-the-Indonesian-Airlines-12.pdf.

⁵⁴ Ridha Aditya Nugraha, “Reviewing Ownership and Control of the Indonesian Airlines”.

⁵⁵ Author analysis based on OAG Aviation data set in 2023. See also Ridha Aditya Nugraha, “Reviewing Ownership and Control of the Indonesian Airlines”.

unprecedented.⁵⁶ Even though in late 2019 Garuda Indonesia Group announced the end of its collaboration with Sriwijaya Group, the Indonesian air market remained concentrated. As a result of the duopoly, the domestic ticket price in Indonesia was relatively high, close to the maximum limit stipulated under the relevant regulations – as Indonesia adheres to the ceiling and floor price concept.

The situation in Indonesia could happen in other ASEAN Member States. In Malaysia, a discussion for AirAsia to merge with Malaysia Airlines to save the flag carrier was brought up in 2020.⁵⁷ The nationalistic and nostalgic reasons (ownership and control) have resulted in limited options to save airlines by way of FDI. As the broader implication, the ASEAN citizens' right to connectivity is compromised.

3.2. ASEAN Open Skies Breakthrough to Achieve Seamless Connectivity

The Third and Fourth Protocol of the ASEAN MAFLPAS are the best solution so far to cope with limited fleet availability. The Third Protocol provides a Member State's airline right to conduct a domestic code-share arrangement⁵⁸ within a territory of another Member State. An important characteristic of code-sharing arrangement is that there is no introduction of new flights as each airline continues to operate the same flight(s) as before the arrangement.⁵⁹ A code-sharing arrangement, which is also characterised as 'virtual merger', could boost regional and domestic connectivity;⁶⁰ provided that the flight capacity, fare, and frequency of the code-sharing airlines are not strictly capped.

The ultimate ASEAN MAFLPAS Fourth Protocol introduced in November 2018 has an even more liberal approach. It aims to increase connectivity through the introduction of co-terminal rights. Pursuant to Article 2 of the ASEAN MAFLPAS Fourth Protocol:

"[t]he designated airline(s) of each Contracting Party shall be allowed to exercise co-terminal rights⁶¹, provided that there shall be no exercise of cabotage rights."⁶²

⁵⁶ "Garuda-Sriwijaya tie up: an Indonesian domestic aviation duopoly?" Center for Asia Pacific Aviation, accessed October 5, 2023, <https://centreforaviation.com/analysis/reports/garuda-sriwijaya-tie-up-an-indonesian-domestic-aviation-duopoly-448786>.

⁵⁷ Krishna N. Das, "Exclusive: AirAsia, Malaysia Airlines merger an option as COVID-19 hits industry – minister", *Reuters*, April 17, 2020, <https://www.reuters.com/article/us-health-coronavirus-malaysia-airlines-idUSKBN21Z15S>.

⁵⁸ Prof. Henri Wassenbergh defines code-share or code-sharing as "...based on contract between air carriers, enabling one of them to extend its scheduled international air services as published under its own code and line numbers operated by itself, to a point or points not served by it and situated beyond a point, most often the terminal point, which it serves with its own services, by including in the publication of its network, connecting services of another carrier or of air carriers as a service of its own, to such beyond points." Henri Wassenbergh, *Principles and Practices in Air Transport Regulation* (Paris: Les Presses IATA, 1993), 166. Based on the definitions above, both airlines (or more) who engage in code-share arrangements will receive benefits by reducing the operating costs and can thus allocate those expenses for any other purpose. On the other side, passengers will receive the benefits by having more flight schedule options.

⁵⁹ Emilia Chiavarelli, "Code-sharing: An Approach to the Open Skies Concept?", *Annals of Air and Space Law* Vol. XX Issue I (1995): 198.

⁶⁰ Ridha Aditya Nugraha, "Legal Issues Surrounding Airline Alliances and Codeshare Arrangements: Insights for the Indonesian and ASEAN Airline Industries", *Indonesia Law Review* Vol. 8 No. 1 (January-April 2018): 58.

⁶¹ The term "co-terminal rights" refers to the right of the designated airline(s) of each other ASEAN Member States (or Contracting Party) to serve two or more points in another ASEAN Member States (or Contracting Party) on the same routing and shall be only available as a part of an international journey. See ASEAN Multilateral Agreement on the Full Liberalisation of Passenger Air Services, Protocol 4 on Co-Terminal Rights between Points within the Territory of any other ASEAN Member States, art. 1.

The Fourth Protocol allows ASEAN Member States airlines to carry out international traffic from their home base in a Member State (A) to more than one airport in another Member State (B1 and B2); without the right to sell tickets solely from B1 to B2. The Fourth Protocol does not constitute the 8th or 9th Freedom of the Air Traffic Rights (also known as cabotage), but allows domestic connections for international flights in another ASEAN Member States. The aircraft physically flying between two points, but without any economic right.

It is clear that the Third and Fourth Protocol breakthrough has no purpose to break the ASEAN Open Skies limit which currently stands at 5th Freedom of the Air. The only ASEAN Member State that has yet to ratify both protocols is Indonesia – showing reluctance possibly rooted in the intention to protect its national airlines, considering the country's huge domestic market share. The other ASEAN Member States who already ratified the protocols, on the other hand, still have to face the challenge of ensuring proper implementation thereof and not merely a lip service. ASEAN Member States are still reluctant in welcoming both protocols as mutual trust is still limited.

The Fourth Protocol is the new face of air service agreement liberalisation in ASEAN. It is a positive catalyst to ensure seamless connectivity, and should be perceived as such. The presence of the Fourth Protocol is essential in the current climate, where post-pandemic lack of fleet among ASEAN Member States' airlines and facing the slow progress of FDI pertaining to airline investment liberalisation are still looming on the horizons.

Finally, both Third and Fourth Protocol are expected to provide legal certainty to investors. Another pandemic might possibly occur in the future. Default still haunts airlines and there is no ASEAN mechanism yet for cross-border insolvency. As ASEAN still need to address legal framework on such issue to encourage community carrier establishment, in parallel the region could be more integrated on the skies.

4. Conclusion

There is a need to look back at the policies on FDI in ASEAN airline industry. Especially in post-pandemic times, seamless air connectivity in the region must be safeguarded in welcoming ASEAN Economic Community 2025. This effort should be in parallel with redefining ownership which should encourage the establishment of ASEAN community carrier. The existing legal framework do not provide a conducive environment for the region' airline industry to have access to higher amount of capital from other ASEAN Member State(s).

ASEAN, through its Transport Working Group, should lay down clear timeframe pertaining to the ASEAN community carrier topic as priority agenda. There is a momentum to discuss this matter in welcoming ASEAN Economic Community 2025 under the ATISA framework. For nationalistic and nostalgic reasons, one may leave the

⁶² The term "cabotage rights" includes the holding out of air services for sale on purely domestic routes by the designated airlines(s) of that Contracting Party. For further reading on cabotage, see Pablo Mendes de Leon, *Cabotage in Air Transport Regulation* (Dordrecht: Martinus Nijhoff, 1992).

so-called flag carriers out of the liberalisation process. However, ASEAN Member States must allow other airlines, who are not designated flag carrier, to have higher access to capital. The bigger ASEAN Member States should first declare their unequivocal approval for a community carrier model to avoid discouragement towards FDI in establishing such an airline.

Stretching ASEAN Open Skies to its maximum limit becomes the most realistic option. Challenges in implementing the ultimate Third and Forth Protocol of the ASEAN MAFLPAS shows that the ASEAN invisible fortress still triumph, while seamless connectivity among ASEAN citizens is struggling. There is a momentum to implement either protocol among routes affected by limited aircraft post-pandemic. ASEAN Transport Working Group should lead such initiative.

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