

ASEAN Open Skies and its implications on airport development strategy in Malaysia

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Introduction

Traditionally, the export competitiveness of a country is viewed in terms of its relative production costs as well as the tariff and non-tariff costs incurred in crossing borders. However, progressive tariff reductions due to multilateral, regional, bilateral and unilateral liberalization have contributed toward the declining importance of tariffs. Conversely, this has led to the progressive importance of other types of trade transactions costs. In particular, the rise of global and regional production networks and the increasing use of just-in-time logistics, inter-modal transport and new security considerations since 9/11 have changed the face of the international economy and with it, the type of trade transactions needed for exporting and importing goods. These transactions comprise a whole range of trade support services needed to send a good from a factory in an exporting country to the importing country. Transportation and logistics support services play a key role in these transactions and therefore can be harnessed to enhance the export competitiveness of a country.

In the case of Association of Southeast Asian Countries (ASEAN) economies, increasing competition from China and to a certain extent India has created a new impetus to enhance their competitiveness, including a renewed effort to improve their transportation and logistics support services for several reasons. First, these economies are competing for Foreign Direct Investment (FDI) whereby multinationals evaluate the viability of each new node in their global and regional production networks based in part on the cost and availability of transport and communications in a host economy for tying that node to others already in the network (Leinbach and Bowen 2004, 305). Second, ASEAN is an important export platform for electronics goods where the final markets are the USA, Europe and Japan. Air cargo services and airports are particularly important because electronic products and in particular, semi-conductors have a high value-to-weight ratio, rapid product cycles and greater risk of damage associated with sea freight. Consequently, semiconductor firms have higher air cargo intensity, thereby rendering cargo services and airports as one of the key determinants of the competitiveness of each node in the production networks of MNCs in this sector. The significant variations in the quality and capacity of air cargo services, including ground-based logistics services in the region further magnifies the importance of these services as sources of competitive advantages to the firms that use these services and the national and regional economies where these firms are located (Leinbach and Bowen 2004, 300). Third, since tourism bears a particularly close relationship to the development of the aviation sector, the increasing demand for air travel has further heightened the importance of

air services and airport development in each member country of ASEAN. Tourism statistics for the region show an upward trend with visiting destinations in different parts of ASEAN as well as increasing domestic travel within each country due to increasing affluence.

However, air services and airports do not operate in a vacuum. Rather their operations are contingent upon the aviation policies of each country and the region. While the objectives of aviation policy and the ability to implement these policies effectively differ significantly between the ASEAN member countries, they have in general relied on bilateral Air Service Agreements (ASAs), although some have joined regional and multilateral arrangements (Forsyth et al. 2006, 146). Studies have shown that the liberalization of air services can lead to new and better air services, thereby increasing trade in airlines services, gains in consumer welfare and in the end, economic growth (InterVistas-ga undated, 11; Forsyth et al. 2006, 147).

Since airport development and the pace of liberalization of air services is determined by the government of each country, this paper seeks to examine the implication of open skies in ASEAN on the airport development strategy in Malaysia. In particular, it examines the government's investment in airport infrastructure and its role in positioning the main international airport, namely the Kuala Lumpur International Airport (KLIA), as a regional hub for air cargo and passenger services

Open Skies in ASEAN

ASEAN was established in 1967 with initially five member countries, namely Indonesia, Malaysia, Philippines, Singapore and Thailand. Its membership increased over time with Brunei joining in 1984, followed by Vietnam in 1995, Laos and Myanmar in 1997 and Cambodia in 1999. ASEAN was formed to promote regional peace, prosperity and stability. It has a total population of about 558 million in 2006 with a combined gross domestic product of US\$1,047 billion and a total trade of US\$1,405 billion (Table 1). The importance of trade to the countries in the region can be seen from the same Table where six out of the nine countries shown (excluding Myanmar) have a trade to Gross Domestic Product (GDP) ratio of more than 100% with Singapore and Malaysia having the greatest dependency on trade in the region.

Given the importance of trade in ASEAN, member countries have recognized that transport is an important area for cooperation as it can contribute toward the reduction of trade transaction costs for member countries and the region as a whole. In this section, open skies in ASEAN is reviewed at three levels; (i) ASEAN-wide initiatives, (ii) sub-regional initiatives within ASEAN and, (iii) unilateral initiatives.

The initial focus as shown in the ASEAN Plan of Action in Transport and Communications 1994-1996 was on the development of multi-modal transport and trade facilitation, improving ASEAN inter-connectivity in telecommunications, harmonization of road transport laws, rules and regulations, the development of rules and regulations for the carriage of dangerous goods and industrial wastes on land and sea as well as human resources development in transport and communications

(ASEAN Secretariat undated (a), 1 <http://www.aseansec.org/7373.htm> Accessed 14 April 2008). In the case of aviation, the improvement of air space management in ASEAN was emphasized with no initiatives then to liberalize air services in ASEAN.

Table 1. ASEAN Key Economic Indicators, 2006

Country	Population (thousand)	GDP (current US\$ million)	GDP per capita (US\$)	Trade per capita (US\$ 2004- 2006)	Trade to GDP ratio (2003- 2005)	Merchandise exports f.o.b. (US\$ mil.)	Merchandise Imports c.i.f. (US\$ mil.)
ASEAN 10							
Brunei	381	6,400	16,798	22,368 (2003- 2005)	147.6 (2003- 2005)	7,700	1,730
Cambodia	14,351	7,193	501	516 (2003- 2005)	133.1 (2003- 2005)	3,800	4,900 (f.o.b.)
Indonesia	223,042	364,459	1,634	562 (2001- 2003)	60.4 (2001- 2003)	103,487	80,333
Lao PDR	5,765	3,404	590	314 (2003- 2005)	69.7 (2003- 2005)	874	1,060
Malaysia	25,767	148,940	5,780	11,603	221.5	160,676	131,152
Myanmar	50,962	n.a.	n.a.	108.0	n.a.	4,250	2,460
Philippines	84,590	116,931	1,382	1,210	99.9	47,037	51,522 (f.o.b.)
Singapore	4,393	132,159	30,084	124,769	454.4	221,772	238,652
Thailand	64,724	206,247	3,187	4,052	143.5	130,790	128,636
Viet Nam	84,108	60,884	724	922	144.4	39,605	44,410

Note: n.a Not available.

Source: <http://stat.wto.org/Home/WSDBHome.aspx?Language=E>
(Accessed on 16 April 2008)

Subsequently, the development of a competitive air services policy was included as one of the integrated implementation program for the ASEAN Plan of Action in Transport and Communications in 1997 (Table 2 and ASEAN Secretariat undated (b), <http://www.aseansec.org/7819.htm> Accessed 15 May 2008). This was targeted at the ASEAN Sub-regional Groupings/Growth Areas. The development of an ASEAN Open-Sky Policy was also considered as another area of possible cooperation. An internal ASEAN Secretariat study on “Preparing ASEAN for Open Sky” was commissioned.

Later in 2002, the ASEAN Memorandum of Understanding on Air Freight Services was inked. However, contracting parties are only allowed to operate all-cargo services up to 100 tons weekly based on a point-to-point route.

In October 2003, the ASEAN leaders signed the Declaration of ASEAN Concord II (Bali Concord II) that aims at establishing an ASEAN Community by 2020. This Community is made up of three pillars, namely the “ASEAN Security Community”,

“ASEAN Economic Community” and “ASEAN Socio-cultural Community”. Both liberalization and cooperation measures are used for the realization of a fully integrated economic community. A progressive approach is used for liberalization with the selection of 11 priority sectors, including air travel and tourism, for accelerated scheduled liberalization by 2010.

Table 2. Liberalization of Air Services in ASEAN

Year	Policies
Integrated Implementation Program for the ASEAN Plan of Action in Transport and Communications, 1997	<ul style="list-style-type: none"> • Implementation of the Competitive Air Services Policy in ASEAN Sub-regional Groupings/Growth Areas; • Development of the ASEAN Open-Sky Policy; • ASEAN Multilateral Agreement on Commercial Rights on Non-Scheduled Services Among the ASEAN Countries
The ASEAN Memorandum of Understanding on Air Freight Services 2002	<ul style="list-style-type: none"> • Liberalization of air freight services in ASEAN as part of the ASEAN Competitive Air Services Policy; • Designated airlines of each contracting party to operate all-cargo services up to 100 tons weekly in each direction, with no limitations on frequency and aircraft types; • Agreement is based on a point-to-point route; • Designated airlines of any contracting party may enter into bilateral code sharing arrangement, with the designated airlines from the other contracting party.
Roadmap for the Integration of Air Travel (RIATS), 2004	<ul style="list-style-type: none"> • Full liberalization of air freight services by December 2008; • ASEAN-wide liberalization of scheduled passenger services, with no limitation in fifth freedom traffic rights for the capital city in each member country by 2010; • ASEAN Open Skies by 2015 as part of the ASEAN Single Aviation Sector
ASEAN Transport Action Plan (2005-2010)	<ul style="list-style-type: none"> • Building on the Roadmap for Integration (RIA) for ASEAN Competitive Air Services Policy

Source: Compiled by author

The Roadmap for Integration of Air Travel Sector, 2004 covers the liberalization of both passenger and cargo air services (Table 2). Full liberalization of ASEAN airfreight services is targeted by December 2008 while ASEAN-wide liberalization of scheduled passenger services is scheduled for December 2010. For the period 2005-2010, ASEAN will promote open-sky arrangements by building on the Roadmap and also through the exploitation of the potentials of full-air freight services liberalization on plurilateral or multilateral basis to support ASEAN travel, trade and investment (ASEAN Secretariat undated(c), <http://www.aseansec.org/16597.htm> Accessed 14 April 2008).

Apart from these ASEAN-wide arrangements, there are also limited open skies agreement within a small sub-set of ASEAN member countries as in the case of the Cambodia, Laos, Myanmar and Vietnam (CLMV) regional air services agreements; Indonesia, Malaysia and Thailand Growth Triangle (IMT-GT); and the Brunei Darussalam, Indonesia, Malaysia and the Philippines BIMP-EAGA Agreement (Forsyth et al 2004, 33). Singapore, together with Brunei, Cambodia and Thailand, concluded a Multilateral Agreement on the Full Liberalization of All Cargo Air Services in 2003 that allows carriers from the four countries to operate unlimited all-cargo services between and via each of the country that is a party to the agreement (<http://app.info.gov.sg> Accessed 4 February 2008). In 2004, Singapore, Brunei and Thailand concluded a similar multilateral agreement for passenger services, providing for unlimited direct flights between any destinations in the three countries.

Individual member countries have their own respective open sky arrangements with non-ASEAN countries. For example, Singapore has followed an open skies policy since the 1960s (Bowen 2000, 29). The traffic rights secured for Singapore Airlines under Singapore's open skies strategy have been integral to the carrier's emergence as one of the world's largest airlines despite its very small domestic traffic base. Thailand, the Philippines and Indonesia have also limited or partial open skies. Malaysia has open skies agreements with the USA, Taiwan, New Zealand, Austria, UAE, Yemen, and the Scandinavian countries apart from 86 bilateral air service agreements (ASAs).

Positioning Malaysia as a Regional Hub

Bowen (2000, 28) highlighted the role of national governments in the development of airline hubs in Southeast Asia. In particular, two factors under the purview of national governments have frequently been used either to reinforce or to overcome prevailing patterns of centrality in regional airline networks and in turn, to ease the access to hub airports. These two factors are the size and quality of airport infrastructure provided at the hub as well as airline competition policy, including the privatization of national carriers and deregulation on domestic routes. The evolution of these two factors in the case of Malaysia is examined in the following section.

Investing in Infrastructure Development

The Kuala Lumpur International Airport (KLIA) was conceptualized in the early 1990s to be a world-class hub airport for the Asia Pacific region. Its development is part of the country's national development strategies whereby sustained investment in infrastructure is made to ensure the timely and adequate supply of facilities that can meet the development requirements of the country (Malaysia 1991, 145; Malaysia 2001, 177). In turn, this sustained investment in infrastructure has enabled Malaysia to be ranked ahead of most of her ASEAN neighbors and China, with the exception of Singapore in terms of the overall quality of infrastructure in the country by the World Economic Forum (as cited in ADB, JBIC and World Bank, 2005).

From 1991 until 2005, Malaysia spent a total of RM63 billion for the development of transport infrastructure in the country (Table 3). A further RM30.3 billion has been allocated for the period of the Ninth Malaysia Plan (9MP: 2006-2010).¹ The amount spent constituted an average of 21 per cent of the total development expenditure of the country from 1991 until 2000. In the last five-year Plan, the total expenditure on transport infrastructure amounted to 28 per cent of total development expenditure while in the current Plan; the amount allocated is 15 per cent of total development expenditure.

Out of this total expended on infrastructure development, there are various competing demands. Road development has consistently taken the largest share (60-65 per cent) of the amount spent or allocated for developing the transport infrastructure in the country. Besides government expenditure, the private sector also expended RM15.2, RM7.9 and RM4 billion respectively during the Sixth, Seventh and Eighth Malaysia Plans under the privatization program of the country.

The second largest share in the amount expended for the development of transport infrastructure accrued to rail development, with the exception of the Sixth Malaysia Plan (6MP: 1991-95) when the amount spent on airport infrastructure took a slightly bigger share at 15.4 per cent due to the development of the KLIA. Port development took the second smallest share in the amount spent on transport infrastructure during the Sixth and Seventh Malaysia Plans (7MP: 1996-2000) while urban transport development had the smallest share. However, during the Eighth Malaysia Plan (8MP: 2001-2005), the amount spent on port development more than doubled from RM1.1 billion to RM2.4 billion due to expansion in capacity and upgrading of port and port-related facilities (Malaysia 2001b, 275). The development of rural roads has been increasingly emphasized since the 8MP, with the amount allocated increasing to RM3.6 billion in the 9MP or a share of 12 per cent of the total amount allocated for transport infrastructure development.

¹ This refers to the latest of the five-year plans in the country that are used to guide the medium development of Malaysia.

Table 3. Government Expenditure on Infrastructure Development in Malaysia, 1991-2010, (in RM million)

Transport Type	1991-1995	1996-2000	2001-2005	2001-2010
	6MP	7MP	8MP	9MP
	Expenditure	Expenditure	Expenditure	Allocation
Total Transport (RM Million)	11594.7	20484.2	30936.5	30304.4
% of total development expenditure of the government	21.2	20.7	28.1	15.2
Roads	7572.6 (65.3)	12269.5 (59.9)	18451.4 (59.6)	17303.1 (57.1)
Urban Transport	95.2 (0.8)	404 (2.0)	706.6 (2.3)	1565.5 (5.2)
Rail	1735.4 (15.0)	5450.3 (26.6)	5270.1 (17.0)	3634.9 (12.0)
Ports	410.9 (3.5)	1089.2 (5.3)	2443 (7.9)	1290 (4.3)
Airports	1780.6 (15.4)	1271.2 (6.2)	1779.3 (5.8)	2868.5 (9.5)
Rural Roads	n.a n.a	n.a n.a	2286.1 (7.4)	3642.4 (12.0)

- Notes: 1. MP - Malaysia Plans.
2. Numbers in parenthesis shows percentage of total transport expenditure.
3. n.a. - not available.

Source: Seventh, Eighth and Ninth Malaysian Plans.

Airport Development

Malaysia in general pursues a liberal, growth-oriented aviation policy. The development of air transport is viewed as an important foreign exchange earner in the services sector, while the development of a comprehensive network of airports is deemed essential for facilitating trade, tourism and to accelerate socio-economic development (Ministry of Transport, <http://www.mot.gov.my> Accessed 29 April 2008). By 2007², Malaysia has 45 airports, including 6 international airports, 19 domestic airports and 20 STOLports (Malaysia undated, 12). The six international airports are the KLIA, Penang International Airport, Langkawi International Airport, Senai International Airport (in Johor state) in Peninsular Malaysia and Kota Kinabalu International Airport in Sabah and Kuching International Airport in Sarawak in East Malaysia.

According to the former Prime Minister, Mahatir Mohamad (1995, 2), the construction of the KLIA was needed as the Subang International Airport had

² STOLports are Short Take-Off Landing airports, which serve communities in the less accessible areas.

experienced a growth of 14-15 per cent per annum from 1990 to 1995. This resulted in the airport reaching its designated capacity of 5,454 passenger movements per hour by the mid-1990s. Capacity at the old Subang International Airport was expanded while the KLIA was being built. With the provision of 10,500 hectares of land, the KLIA is designed to be a world-class airport and a regional hub for the Asia Pacific region. Its development spanned several phases: Its first phase was completed on 30 June 1998, after seven years of conceptualization with a capacity of 25 million passengers per annum and 1.2 million metric ton of cargo (Table 4).

During the second phase (1998-2015), a temporary Low Cost Carrier Terminal (LCCT) was constructed on a fast-track basis at the beginning of June 2005 and was fully operational on March 2006, at a cost of RM108 million (www.lcct.com.my 7 May 2007). The LCCT is located about 20 kilometers from the KLIA Main Terminal Building and has the capacity of handling 10 million passengers a year. It is projected that this capacity will be exhausted by 2012. The current facilities will be upgraded to handle up to 15 million passengers per year by 2015, thereby increasing the total capacity at KLIA to 40 million passengers per year.

Table 4. Summary of the Development of KLIA

Phase	Year	Description
1	1993-98*	<ul style="list-style-type: none"> Initial capacity of 25 million passengers per annum (ppa); 1.2 million tones cargo; one main terminal, one satellite building
2	1998-2015	<ul style="list-style-type: none"> Addition of LCT, adding 10 million ppa by 2012; Includes the expansion of current LCCT up to 15 million ppa by 2015. Total capacity of main terminal and upgraded LCCT will be 40 million ppa.
3	2010-2015 (forthcoming Tenth Malaysia Plan)	<ul style="list-style-type: none"> New LCCT (permanent) will be constructed to accommodate 25 million ppa, capacity of main terminal and new LCCT will be 50 million ppa; Construction of second satellite terminal and increase in passenger capacity to possibly 75 million ppa.
4	Dates not known	<ul style="list-style-type: none"> Construction of second terminal and increase in capacity to 100 million ppa.

Source: * Mahatir 1995, and interview with Ministry of Transport, 22 May 2008.

In 2008, the government announced that a new permanent LCCT will be built in three to four years time with a capacity of handling 25 million passengers a year, thereby increasing the capacity of KLIA to 50 million ppa. The new terminal will be located closer to the main terminal than the existing one and an Express Rail Link service will be built to link the new LCCT with the main terminal. It is expected that this new facility will be built together with the second satellite terminal during the forthcoming

Tenth Malaysia Plan (2010-2015). The new satellite terminal and new LCCT will probably increase the capacity of KLIA to 75 million ppa.

There is, however, sufficient land and capacity to develop facilities to handle up to 100 million passengers and five million metric ton of cargo per annum, including four runways by 2020.

Malaysia Airports Holdings Berhad (MAHB), a privatized entity, manages and operates all the airports in the country, with the exception of the Senai Airport in Johor and the Kerteh Airport in Terengganu. MAHB was incorporated in 1991 when the Malaysian Parliament passed a bill to separate the Department of Civil Aviation into two entities with different responsibilities. DCA remains the regulatory body for the airports and aviation industry in Malaysia while MAHB focuses on the operation, management and maintenance of airports. MAHB was subsequently listed in the Kuala Lumpur Stock Exchange in November 1999. The major shareholder is Khazanah National Bhd, a government investment holding company (73%), while the foreign share amounted to 2.6 per cent in 2005 (MAHB Annual Report 2005, 239).

Around 2004, the government designated Senai Airport in Johor (and next to Singapore) as the regional air cargo hub in an attempt to overcome the leakage of cargo from Malaysia that is being exported through Singapore. In view of this, RM100 million was approved under the Ninth Malaysia Plan to upgrade the facilities at this airport to facilitate the export of goods that are produced from the southern part of Malaysia that have found it more efficient to export through Singapore instead of the KLIA (Interview MOT 12 May 2008).

Road Development

Apart from airports, road development is also important as it facilitates the movement of goods and people within the country. Total road network, comprising Federal and state roads, increased from a total of 53,984 in 1990 to 77,673 kilometers in 2005. The total amount spent for road development from 1991-2005 amounted to RM38.4 billion from the government and another RM27.1 billion from the private sector.

Road density has increased from 0.16 in 1990 to 0.24 kilometer of road per square kilometer in 2005, representing a 50 per cent increase in road coverage and accessibility in any given area (Table 4). The road development index also showed improvement from 0.7 in 1990 to 0.85 in 2005 while the road service level improved from 2.96 kilometers per 1,000 population to 3.02 from 1995 to 2005.

Generally, the road infrastructure is better on the west coast of Peninsular Malaysia compared with the east coast and East Malaysia as the major cities and industries are located on the west coast of the peninsular. A major development during the period under study is the construction of highways and expressways to connect all major cities and towns on the west coast of Peninsular Malaysia. The development of these highways and expressways was guided by the Highway Network Development Plan (1993-2004). Major road networks were privatized since the passing of the Federal

Roads (Private Management) Act in 1984, in order to accelerate the construction of major expressways or highways and to reduce the fiscal burden. During the 8MP, (2001-2005), 16 privatized highway projects were undertaken to construct as additional 604.5 kilometers of the national road network, involving a capital expenditure of RM18.0 billion (Malaysia 2006a, 224). Most of these projects were implemented through the Built-Operate-Transfer (BOT) System, which requires the private sector to construct, operate and maintain the facility using its own funds and in return, collect toll from the road users during the concession period. At the end of the concession period, the facilities will be transferred at no cost to the government. PLUS Expressways Bhd is the biggest of the highway concessionaires, operating approximately 85 per cent of the country's highways. As at 2006, the total length of these toll highways is 1,238 kilometers. While some of privatized highways are interstate in nature, quite a few are localized to Kuala Lumpur to ease the traffic congestion in the capital city.

Table 5. Road Development Indicators, 1990 – 2005

Indicator	Level of Development			
	1990	1995	2000	2005
Road Density ¹	0.16	0.19	0.20	0.24
Road Development Index ²	0.7	0.74	0.75	0.85
Road Service Level ³	n.a	2.96	2.98	3.02

Notes: 1. Road Density measures road length over the total area.

2. Road Development Index measures the level of road development taking into account both area and population size of the country.

3. Road Service Level measures total road length per 1,000 population.

Source: Seventh (pp. 348); Eighth (pp. 270) and Ninth Malaysian Plans (pp.377).

The North-South Expressway, linking the northern tip of Peninsular Malaysia (Kayu Hitam in Kedah state³) to the southern tip (Johor Baru), was constructed progressively by sections from 1981 till 1994. It spans 847 kilometers and has reportedly lowered perceived vehicle operating and time saving cost by 25 per cent per trip, after taking into account toll charges (Malaysia 1996, 344). This expressway is also linked to the KLIA *via* the North-South Central Link expressway. It is also part of the Asian Highway Network, which also connects into Thailand and Singapore.

In the case of Penang, since the state is geographically and administratively divided between the island of Penang and Seberang Perai on the peninsular side, the Penang Bridge was constructed in 1982 and completed in 1985 to link the island with the hinterland. Due to the heavy volume of traffic, the bridge is currently broadened from the current two lanes to three lanes. Penang is linked to the North-South Expressway on its Seberang Perai side. In 2006, the government announced that a second bridge will be built under the Ninth Malaysia Plan.

³ Malaysia is a federation of 13 states and 3 federal territories.

Johor, the southernmost state in Malaysia is linked to Singapore via the Johor Causeway and the Malaysia-Singapore Second Crossing. This second link cost RM1.6 billion and was ready in 1997 (Malaysia 1996, 346).

Airlines Development

National Carrier: Malaysian Airlines

Malaysia Airlines (MAS), the national carrier started as a company when it was incorporated under the Companies Act in 1971 (Khairiah 2008, 118). Although totally owned by the government then, the company was termed as an off-budget agency (OBA) as the day-to-day running of the company was outside the control of the government. It has its own employment policies and salary scheme and arranged its own funding and had no access to government loans. However, the government did provide support to the company in terms of government guarantees.

It was the first government agency that was privatized in 1985 as it was already a body incorporated under the Companies Act. Upon listing, 30 per cent of its equity was offered to the public while the government retained a 70 per cent share, with a long-term strategy to eventually reduce it to 30 per cent in order to enable the government to appoint directors, including the chairman and the managing director.

Although the government's share did fall over time, the carrier's poor financial performance and costly fleet expansion subsequently slowed the pace of further privatization through public offerings (Bowen and Leinbach 1995, 483). In 1994, 32 per cent of the government's shares in MAS were sold to a single individual, Tajudin Ramli, resulting in the government's share falling to just 10 per cent.

In 2000, six years after the government had privatized its controlling stake to Tajudin Ramli, MAS incurred RM9.5 billion in debt and four consecutive years of losses. Consequently, the government renationalized MAS in 2000 by buying back Tajudin's shares at RM8 each, although the prevailing market price was RM3.62. Some of the losses incurred were attributed to artificially low domestic fares that were imposed by the government. Hence, it continued to suffer losses after re-nationalization until 2002/2003 and 2003/04. In the year 2005, MAS reported a loss of RM1.3 million due to increasing fuel costs and high operating costs.

A new Chief Operating Officer was appointed in 2005 and MAS launched its Business Turnaround Plan in 2006. The turnaround plan contained a series of specific cost and revenue actions to curtail further losses due to low yields, inefficient networks and other factors such as poor pricing, rising cost structure, a mismatched fleet, weak operational performance, as well as significant social and political obligations (MAS 2006,18). Several new initiatives were implemented, including route rationalization, rescheduling all of its flight timing, diversifying its revenues, and changing its mode of operations from point to point services to hub and spoke services.

As part of its domestic route rationalization, MAS initially relinquished 96 of its non-trunk route to Air Asia, leaving it to operate 22 routes. It has subsequently reinstated some of the routes and now competes with Air Asia on 25 trunk routes (MAS 2007, 78). International routes were also rationalized from 114 to 90. Since it is not a member of any of the global alliances, MAS has embarked on a plan to form a network that resembles an alliance without joining an alliance. For example, Malaysia has code share arrangements with Northwest Alliance and KLM/Air France, which in turn are members of the Sky Team (Mahani et al 2005, 20). Based on multiple code share agreements, MAS has a global network that comprises 16 domestic and 82 international destinations at the end of 2007. Of the international destinations, 24 are serviced together with other airline partners.

The company subsequently registered profits in 2007, ending a series of losses since 2005.

Emergence of Low-cost Carriers: Air Asia, and Firefly

In 2001, the government approved the establishment of the first low cost carrier based in Malaysia, namely Air Asia. The airline is not new as a government-owned conglomerate established it in 1993 but it was heavily in debt when it was sold to Tony Fernandes' company Tune Air Sdn. Bhd for the token sum of one ringgit. Fernandes then proceeded to reengineer the airline, turning in a profit in 2002.

Table 6. Summary of the developments of Air Asia

2001	Air Asia sold to Tony Fernandes for the purpose of establishing a low-cost carrier based in Malaysia
2003	Established a second hub at Senai Airport in Johor Baru, near Singapore; Established Thai Air Asia as a joint venture with Shin Corporation; Launched its first international flight to Bangkok
2004	Acquired Awair, and Indonesian airline
2005	Rebranded Awair as Indonesia Air Asia
2006	As part of MAS route rationalization program, 96 non-trunk routes, in addition to 19 domestic trunk routes were transferred to Air Asia.
2007	Long-haul services from Kuala Lumpur to Australia and China using Airbus A330 offered by Air Asia X
2008	Vina Air Asia, to be operating out of Hanoi, Vietnam

Source: Compiled by author

Although it was initially established as a domestic carrier, it has since spread its wings to the international arena, with its first international inaugural flight to Bangkok (Table 6). With the rapid expansion of domestic and international routes, the number of passengers traveling by Air Asia has grown strongly from 5.8 million in 2006 to

8.7 million to 2007. Cumulative passengers of the total group of companies amounted to 30 million by the end of the calendar year 2006. It has received several awards since its establishment, notably Asia's Best Budget Airline under the Best in Travel Poll 2007 by SmartTravel Asia.com and the Best Low Cost Airlines in Asia in 2007 by SkyTrax.

Firefly, a wholly owned subsidiary of MAS, was established in 2007 as a budget airline to compete with Air Asia and to develop additional business streams to increase profit. With a hub in Penang, the airline flies to a few destinations in Malaysia, Indonesia, and Thailand. The carrier is targeted to compliment MAS by flying to destinations that are not financially viable for MAS so that both operations can match the needs of full service passenger and budget travelers.

Specific Policies

In the case of Malaysia, besides investing in infrastructure and controlling airline competition, the government also implemented some specific policies to promote KLIA as a regional hub. For example, the KLIA Hubbing Development Committee was set up in December 2000 (Malaysia 2001, 278). This committee is made up of one representative from MAHB, two representatives from the Ministry of Transport and one representative from the Ministry of Finance. The committee meets once a year to examine three areas for the development of the KLIA: traffic facilities, connectivity through MAS service, and marketing (WTTC 2001, 18). It also sets performance and services standards for the KLIA based on world best practices. The KLIA Hubbing Unit was subsequently set up within the Aviation Department in the Ministry of Transport to liaise between the Committee and MAHB in the implementation of the plans proposed by the Committee. This unit oversees the utilization of the Trust Fund that was set up to attract airlines to the KLIA.

A Free Commercial Zone was also set up to facilitate the handling of cargo at the KLIA. The FCZ uses the paperless environment concept with value added activities such as trading, break bulking, grading, sorting, re-packing and re-labeling. A one-stop center is also provided to expedite the process of cargo clearance with additional support services such as multi-banking services, clinics, food and beverage and also postal services.

Government-to-government promotional activities are regularly conducted through air talks with other countries. Joint-promotional activities with MAHB and the Ministry of Tourism are also used to market KLIA. Malaysia has not revised its airport tariffs since 1969 and KLIA has one of the lowest tariffs in the world.

Preparing for ASEAN Open Sky: Key Issues

Promoting KLIA

An aggressive marketing strategy was launched for the period 2006-2010 to promote KLIA as part of its 5-Year Transformation Strategy (MAHB Annual Report 2006,

26). This included among others, the extension of the Airline Incentive Program that was launched to the end of 2007 to attract more foreign airlines to fly into KLIA as well as the other four international airports managed by the MAHB. Incentives given under the Program include free landing and parking charges for new foreign airlines and existing airlines mounting new destinations and additional frequencies for a minimum period of three years (MOT 12 May interview). New foreign airlines were also offered free office rental space for 6 months as well as marketing support fund for new airlines operating in KLIA. MAHB is currently working on a new set of incentives that will go into effect by 2008.

The government also provided a budget of US\$131,579 over a three-year period for promotional activities and incentives for new airlines introducing passenger or freighter services (Ahmad Husni 2004, 3).

MAHB also attends major aviation-related forums all over the world as part of its marketing and promotional efforts. In 2006, it participated in no less than 120 meetings with various airlines to present marketing proposals and route analysis (MAHB Annual Report 2006, 37). It will be hosting the 14th World Route Development Forum or Routes KL in October 2008, making it the first Asian country to host this important airline-networking event, which is traditionally held annually in Europe. It is hoped that this event will attract some US airlines to operate from KLIA as there are so far no US airlines operating from it.

As part of MAHB's efforts to diversify its non-aeronautical activities, commercial activities were stepped up with the establishment of a Commercial Management Department in September 2006 to oversee business development and to manage the related policies and procedures for MAHB's system of airports. This included among others, the Retail Optimization Project to enhance the shopping-cum-dining experience of the KLIA and other international airports managed by MAHB. MAHB has invested RM50 million on this project, which is slated for completion in July 2009 (New Straits Times, May 21 2008, page 27). This project aims to expand the airport's commercial revenue by increasing the average spent per passenger through the maximization of retail space and improvement in retail placement.

According to the Ministry of Transport, as of 2008, there are 50 foreign airlines and full-freighters (UPS, Fedex and Cargolux) operating at the KLIA. Passenger traffic (excluding transit passengers) has grown almost four fold since its inception in 1998 (6.4 million ppa) to 23.7 million ppa in 2006 (MOT statistics, www.mot.gov Accessed 2 May 2008). Cargo handled increased (excluding cargo in transit) slightly more than four fold from 159,741 tonnes in 1998 to 672,888 tonnes in 2006.

KLIA won the Airport Service Quality (ACI-ASQ) Award for the World's Best Airport in the 15-25 million ppa category for three consecutive years from 2005-2007. It was also voted the Best Airport Worldwide and Best Airport in the Asia Pacific region in the same award. Its Low-Cost Carrier Terminal-KLIA (LCCT-KLIA) was named by the Center for Asia Pacific Aviation (CAPA) as the Low Cost Airport of the Year in 2006).

Increasing Domestic Competition

As in the case of other countries, the introduction of second tier airlines such as SilkAir, Eva Airways, Japan Asia Airways, All Nippon Airways, Asiana, Sempati and DragonAir has injected competition for established national carriers, some of which have long operated as a monopoly in their home countries (Chin 1997, 127). Although Air Asia started out as a LCC in the domestic sector, it has since ventured beyond Malaysian shores and it has started to include long-haul services since 2007. Since then competition has heightened between the full service carrier (FSC) and the low cost carrier (LCC). First in February 2008, the virtual monopoly of MAS and SIA on the Kuala Lumpur-Singapore route was ended with entry of three budget carriers on this route. This lucrative route was served by 180 flights a week by MAS and SIA and 14 flights by Japan Airlines under 'Fifth Freedom' rights prior to 2008. Air Asia from Malaysia, Tiger Airways⁴ and Jetstar Asia from Singapore have been allowed limited flights on this route. MAS and Singapore Airlines (SIA) will be terminating the 30 year old Shuttle Agreement⁵ (which lets MAS and SIA fix fares) as of June 2008 (NST Biz News Saturday May 17 2008, page 35). This route may be underserved considering the strong bilateral economic ties between Malaysia and Singapore and as compared to the 375 weekly Singapore-Jakarta flights as well as 307 bilateral weekly flights between Singapore-Bangkok. The opening is viewed as a significant development in the history of ASEAN airline industry and an important first step toward the liberalization of air services in the ASEAN region.

Second, in May the same year, MAS became the first FCC to offer "free seats" or seats that charge only surcharges such as fuel, insurance, airport tax, and administration fee for all domestic destinations. MAS subsequently extended this offer to all destinations within ASEAN countries, with the exception of Yangon. Its subsidiary is also offering zero fares for all its routes. Since the zero fare strategy is usually a model used only by LCCs, the new strategy of MAS to sell its unsold seats in the domestic and ASEAN routes has triggered a new fare scheme from Air Asia to better the offer of MAS. It is unclear whether the competition between the two will end up with one exiting the industry as the low fare strategy of MAS is presented as a permanent means for reducing the annual 4 million unsold seats in the domestic and ASEAN sectors of the FSC (The Sun May 15 2008, 24)

Promoting Tourism

Since tourism bears a close relationship with the development of the aviation sector, various incentives are given to encourage the development of the tourism sector in Malaysia. For example, the Promotion of Investment Act of 1986 promotes the

⁴ Tiger Airways is jointly owned by SIA (49 per cent), Indigo Partners LLC (24 per cent), Irelandia Investments Ltd. (16 per cent) and Temasek Holdings (11 per cent), while Jetstar Asia is a joint venture company by Australina airline company, Qantas which holds a 49 per cent equity, Temasek Holdings (19 per cent) and a group of Singaporean businessmen (32 per cent) (Bernama 30 January 2008, Singapore).

⁵ Under the Shuttle Agreement, the carriers agree on a common fare to charge customers who turned up at the airport on standby for the next flight.

establishment and development of industrial, agricultural and other commercial enterprises in Malaysia through tax incentives. For the tourism sector, these incentives are available to hotel accommodation projects and other tourist projects. They include pioneer status, investment tax allowances, industrial building allowances, duty exemptions, income tax exemptions, and reductions in service tax. For example, companies building luxury ships are eligible to apply for pioneer status. In addition, sector specific incentives were also granted (See Appendix 1 for the list). It was reported that during the period, 1996-2005, 360 hotel projects were granted tax incentives, 30 tourist projects were also granted incentives and 180 budget hotels were also given tax incentives to encourage domestic tourism (Malaysia 2006b, 559).

Numerous tourism products were introduced over the years, such as eco-tourism, agro-tourism home-stay programmes, cultural and heritage tourism, thematic events, meetings, incentives, conventions and exhibitions, sports and recreation tourism, education, and health tourism. Malaysia My Second Home was also introduced to encourage foreigners, their spouses and their dependents to select Malaysia as their second home.

Following the relative success of the Visit Thailand Year in 1987, Malaysia also launched its own Visit Malaysia Year (VMY) campaigns. In 2007, Malaysia launched its Third VMY campaign, after two previous campaigns in 1990 and 1994. The current VMY campaign has targeted more than 20 million visitors and a revenue of more than RM44 million. In January 2008, it was reported 20.9 million foreign visitors visited Malaysia in 2007 and the tourism industry generated RM46.1 billion in revenue in the same year (Ministry of Tourism undated).

The number of tourist arrival more than doubled from 7.5 million in 1995 to 16.4 million in 2005 (Table 7). Total tourists receipts have grown from RM9.2 billion to RM31.0 billion over the same duration. By 2020, tourist arrivals are expected to reach 24 million while tourist receipts are expected to reach RM59.4 billion (Malaysia 2006b, 560). Employment in this sector has grown from 67,214 in 1995 to 451,000 in 2005. ASEAN, the traditional source of tourist visitors for Malaysia remained the largest country of origin with a share of 77% in 2005 while the share of Japanese tourists have declined from 4.4% in 1995 to 1.9% in 2005. On the other hand, tourists from China and West Asia have increased in numbers. The importance of this sector as a source of foreign exchange earnings can be seen in the increase in the **net** contribution by tourism from RM11.2 billion in 2000 to RM18.1 billion in 2005 (Malaysia 2006a, 193). Spill-overs from this sector to other sectors such as hotels can be seen in the increase in the number of hotels and hotel rooms as well as the average occupancy rate over time.

Long-term strategies include the revival of long-haul markets (such as North Asia, Europe, North America and Oceania), maintaining the current focus on fast growing markets such as China, India and West Asia, and capitalizing the Malaysia Truly Asia campaign (Tengku Adnan 2006). New growth areas such as emerging markets, niche products, and promotion of special events such as F1 Grand Prix will also be promoted. The Ministry is also keen to see that the economic and social benefits from

international tourism are dispersed beyond the major cities and tourist regions in the country.

Table 7. Selected Tourism Indicators, 1995, 2000, 2005 and 2010

Indicator	1995	2000	2005	2010
Number of Tourist Arrivals (million)	7.5	10.2	16.4	24
By Country of Origin (%)				
ASEAN	73.5	70.4	76.8	65.0
China	1.4	4.2	3.8	6.1
Japan	4.4	4.5	1.9	2.2
Australia	1.8	2.3	1.5	2.7
United Kingdom	2.2	2.3	1.5	2.8
Taiwan	3.9	2.1	1.3	2.7
India	0.4	1.3	1.2	1.8
West Asia*	n.a	0.5	1.0	2.7
Hong Kong SAR**	2.0	n.a	n.a	n.a
USA**	1.3	n.a	n.a	n.a
Others	9.1	12.4	11.0	14.0
Total Tourist Receipts ¹ (RM billion)	9.2	17.3	31.0	59.4
Per Capita Expenditure* (RM)	n.a	1,696	1,890	2,417
Average Length of Stay (nights)	4.8	5.8	7.2	8.7
Number of Hotels	1,220	1,492	2,256	3,218
Number of Hotel Rooms	76,373	124,413	170,873	247,008
Average Occupancy Rate of Hotel (%)	65.5	59.2	63.5	66.4
Employment	67,214	390,600	451,000	520,700

Notes:

* Not available in Eighth Malaysia Plan 2001-2005

** Not available in Ninth Malaysia Plan 2006-2010

¹ Tourist receipts exclude excursionist receipts.

Sources: Eighth Malaysia Plan 2001-2005 and Ninth Malaysia Plan 2006-201

Competing within ASEAN

Government investment in infrastructure to boost the competitiveness of their airports is a strategy that is also used by other major airports in ASEAN. Within ASEAN, dominant airports have for a long time been Bangkok and Singapore as these two airports are strategically located geographically to capture the European and Northeast Asian traffic and interregional connections. Both Singapore and Thailand have also invested heavily in the infrastructure of their respective international airports to enhance their competitiveness as hubs for the region.

Singapore, for example, completed a S\$240 million upgrade of its Terminal 2 just before Thailand opened its new international airport in 2006. Subsequently, Singapore opened its S\$1.75 billion Terminal 3 in January 2008, increasing its capacity to 64 million. It is reported in March 2008, that the city-state is already planning for a Terminal 4 (CNA, posted 06 March 2008 1715 hrs). This is in line

with its strategy to use capacity expansion as a purposeful investment signaling strategy in order to capture new demand and to tilt the market share in the Southeast region toward Changi (Phang 2003, 31; KPMG 2007, 24). Its Budget Terminal that was opened in March 2006 with a capacity of 2.7 million passengers will also be expanded at a cost of S\$10 million to be completed by early 2009. Changi also caters for the other end of the spectrum as “commercially important people” are provided five-star services in JetQuay, a facility adjacent to the main terminals with dedicated customs, immigration, personal concierge and limousine transport to the aircraft (KPMG 2007, 25). It has nine cargo terminals with a total capacity of 3 million tones per year. Two express freight centers cater to the express cargo sector, with DHL using Singapore as its regional hub.

Thailand has also recently opened its new international airport, the Suvarnabhumi International Airport in 2006, at a cost of US\$3.0 billion and with a capacity of 45 million passengers a year. A budget terminal is also planned for 2008 and it is expected that this to increase the capacity of Suvarnabhumi by another 17 million, with a final target of 100 million. Airfreight facilities at the Suvarnabhumi airport are designed to handle up to 3 million tones of cargo per year. Thailand’s airport sector has benefited from the large tourism sector in the country with foreign tourists accounting for over 80 per cent of visitors to Thailand (KPMG 2007, 30).

Changi, Suvarnabhumi and KLIA are all departing from the traditional model of airport development whereby the main revenue is derived from airlines through charges for landing and parking. Instead, all three airports have increasingly tapped on non-aeronautical businesses such as retail outlets, restaurants, entertainment etc that can also cater for non-traveling visitors. Non-aeronautical revenues accounted for, respectively 60 per cent, 35 per cent and 19 per cent of the airport revenues of Changi, Suvarnabhumi and KLIA (KPMG 2007).

Changi has often been acknowledged as one of the best airports in the world in surveys conducted by international aviation organizations as well as academic studies. For example, Park (2003) used a five core-factor groups⁶, multi-decision criteria model to analyze the competitive strengths of seven Asian airports (Park 2003, 355). He found Changi, together with the new Hong Kong International Airport and Seoul Incheon International Airport to be more competitive while KLIA, Kansai and Narita to be less competitive.

Despite Changi’s long-standing competitiveness, KLIA is catching up. In 2007, the Airports Council International (ACI) Airport Service Quality Awards nominated KLIA as the best for the 15-25 million passengers’ category while Changi which handled 35 million passengers in 2006, finished second, after Incheon Airport in South Korea, in the category for 25-40 million passengers’ category.

For the overall prize – Best Airport Worldwide – Incheon finished first, Hong Kong’s Chek Lap Kok second, KLIA third while Changi finished fourth. In another poll by Smart Travel Asia, an independent online travel magazine, Hong Kong International

⁶ The five factors are spatial, facility, demand, service and managerial factors.

Airport, Singapore Changi, KLIA were the top three while Suvarnabhumi finished fourth.

In terms of the competitiveness of the respective country carriers, Singapore Airlines ranked third among the top 50 carriers ranked by IATA in 2007 while Thai Airways and MAS ranked 18 and 48 respectively. MAS was awarded the Skytrax 5-Star Airline Award in 2006.

Policy Implications

Review policy to establish a regional cargo hub at Senai

While it has been reported that that as much as 25-30 per cent of airfreight throughput are channeled through Singapore (Malaysia 2006b, 727), this does not imply that it is necessary to set up a separate air freight airport at Senai to stop the leakage. First, it is not necessarily the distance from the southern part of Malaysia to KLIA that is the cause of the leakage. INTEL, which is producing in the north of Malaysia, reported that some of their chips are exported through Singapore due to the flexibility of flight connectivity (Tham et al 2007, 38). Flight connectivity thus play a critical role in the choice of airports.

Second, the electronics hubs in Malaysia are in Penang in the north and the Klang Valley in the central part of Malaysia and not in the southern state of Johor where the Senai is located. Given the importance of time in the delivery cycle of these goods, E&E goods are exported mainly through the Penang airport and the KLIA. Third, there is unutilized capacity as well as room to expand the capacity at KLIA. In 2007, the number of passengers per annum at the main terminal was 19 million while the LCCT contributed another 7.7 million (Interview MOT 22 May 2008). Since the capacity of the main terminal is 25 million ppa, there is still excess capacity at the main terminal. Similarly, there is excess capacity in cargo as KLIA handled a total of 672,888 tonnes of cargo in 2006, which is well below its capacity of 1.2 million tones a year. Fourth, although the air transport industry serves two heterogeneous markets, namely freighters and passengers, it uses the same technology for both. Moreover, most airlines carry both passengers and cargo. It is therefore better to focus on the development of KLIA as the regional hub for both passengers and cargo as airlines serve two types of clients, namely passengers and cargo. Dedicated air freighter airlines can also utilize the facilities that have been developed to serve both passengers and cargo transactions.

Strategy for MAS: Joining a strategic global alliance

In 2006, MAS was reported to have an intention to join Sky Team as part of its plans to rationalize its international destinations under the hub concept (Centre for Asia Pacific Aviation, 6 March 2006). Subsequently, MAS launched its own MAS Overall Strategic Alliance Integration Concept (Project MOSIAC) together with its Business Turnaround Plan for the period 2006-2012. This is essentially a code share alliance with other airlines so as to expand MAS's network. Nevertheless, the airline industry

is dominated by global alliances that have been formed since the early part of the nineties. Being global in scope, these alliances are the most significant in terms of network expansion. Although it is possible to establish various partnerships with individual airlines across different global alliance groups, the number and extent of ‘side alliance deals’ will decrease over time as the global reach of each alliance network improves (Oum 2001, 5).

In 2000, Oum reported that five alliance groups accounted for 57 per cent of the world’s total revenue passenger kilometers (RPK), a widely used measure of airline industry output (Table 8). Other indicators such as global passenger shares and operating revenue shares also show the substantial shares accruing to global alliance groups. This concentration of RPK, global passengers and operating revenues in the hands of global alliance groups has grown over time when 2000 is compared to 2007. By 2007, the share of RPK in the hands of the top three alliance groups (Star Alliance, Oneworld and Skyteam) amounted to 59.1 per cent while the share of global passengers and operating revenue controlled by them are 63.8 per cent and 67.4 per cent, respectively. This shows clearly that the market is getting more and more concentrated. Within ASEAN, both Thai Airlines and Singapore Airlines are members of the leading alliance group, the Star Alliance.

Table 8. Global Alliance Group Market Shares, 2000 and 2007 (%)

Alliance	Revenue Passenger Kilometers		Global Passenger Shares		Operating Revenue Shares	
	2000	2007	2000	2007	2000	2007
Star Alliance	21.3	26.1	18.8	25.1	20.9	27.2
Oneworld	16.4	20.7	12.8	17.9	15.0	20.0
Air France/Delta, Wings and Qualifyer	19.5	n.a.	17.6	n.a.	17.6	n.a.
Skyteam	Just formed	22.3	Just formed	20.8	Just formed	20.2
Others	42.8	30.9	50.8	36.2	46.5	32.6

Sources: Oum 2001 and Star Alliance 2007 (<http://www.staralliance.com> Accessed 23 May 2007).

Global alliances can also contribute to productivity enhancement, competitive pricing and profitability of its partners as alliance partners generally increase traffic routing via their intercontinental alliance gateway airports after the strategic alliances (Oum 2001, 41). Bowen (2000, 39) also showed that an airline that is more successful in forming alliances will draw more traffic feed from around the world to its primary hub.

Given the trend shown in Table 8 and the generally positive impact of alliances on the performance of the airlines, it is imperative for MAS to join a global alliance to improve its market feed.

Developing a distinctive product appeal for tourism

Within ASEAN, Thailand is the acknowledged leader for long-haul tourists from Europe and North America. Both Singapore and Thailand have been able to tap on the tourist market through different strategies. Thailand, for example, offers diverse tourist attractions while Singapore, despite lacking many natural tourism products has managed to sell itself as the gateway to nearby tourist destinations of the region as well as through its theme parks (Bowen 2000, 27).

Malaysia has not been able to tap extensively on the long-haul visitors market from outside ASEAN, despite sharing many similar tourism features with Thailand such as sun and surf tourism, eco-tourism, heritage tourism as well as medical and health and well-being tourism. Although Malaysia was ranked below Singapore but above Thailand in the Travel and Tourism Competitiveness index for 2008⁷, 74.5 per cent of its tourist arrivals in 2007 are from ASEAN countries, with Singapore contributing as much as 67 per cent of the ASEAN arrivals (Ministry of Tourism undated). As noted by the World Travel and Tourism Council (2001, 4), the main problem with Malaysia's tourism lies in its image and the development of a distinctive product appeal that will enable it to distinguish itself from its competitors within Southeast Asia. Even its current tag line, 'Malaysia- Truly Asia' differentiates itself too little from its competitors in the region, namely Singapore's 'New Asia' and Indonesia's 'Endless Beauty of Diversity'.

Realizing the ASEAN Community

As noted by Chin (1997, 128), unlike London-Paris-Amsterdam, which are gateways to a large hinterland and great concentration of population and activities, Southeast Asia is both fragmented and insular. At the same time, the rapid development of major international airports such as Suvarnabhumi, Changi and KLIA within relatively short distances, through heavy investment in infrastructure, has raised concerns as to whether supply will outstrip demand, leading to underutilization of some of these airports.

While the liberalization of the transport sector will undoubtedly help to facilitate the movement of goods and services within ASEAN, an increase in demand will be greatly assisted by the early realization of the ASEAN Community. This includes not just the initiatives taken to liberalize the transportation sector, including air transport but also the whole gamut of policies and initiatives that have been postulated for the realization of the ASEAN Community. Although ASEAN has made great efforts to liberalize trade under the ASEAN Free Trade Agreement (AFTA) as witnessed by the reduction in tariffs among member countries, progress on liberalization of the services sector is still slow. Despite five rounds of negotiations to liberalize the services sector since 1995, substantial barriers continue to limit the regional integration of this sector

⁷ Singapore, Malaysia, and Thailand were ranked 16, 32 and 42, respectively out of a total of 130 countries worldwide. See www.weforum.org Travel and Tourism Competitiveness Report 2008. Accessed 29 May 2008.

within ASEAN. Clearly, greater political will is needed for the realization of the ASEAN community. At the same time, the arrival of an ASEAN community will allow the region to tap on its extra-regional ties, leading to the possibility of the East Asian community, with ASEAN as the driver.

Conclusion

ASEAN countries have adopted a policy of moving toward open skies in recognition of the important role played by transportation and in particular the aviation sector in linking these mostly export-oriented economies with the global economy. Given the region's history of planned development and cautious approach toward liberalization, it is not surprising that this liberalization is staged over several years with 2015 as the deadline for the attainment of open skies in ASEAN.

Is Malaysia poised to gain from open skies in ASEAN? The review of infrastructure development in this paper shows that Malaysia has invested substantially in overall infrastructure development, including airports in its pursuit of economic development. This overall focus on total infrastructure development places Malaysia well ahead of most of its regional neighbors in the competitive ladder, with the exception of Singapore. While investment in infrastructure also aids in the development of KLIA as a regional hub, other member countries within ASEAN, notably Singapore and Thailand have also followed a similar investment-intensive strategy to develop their international airports, namely Changi and Suvarnabhumi as a regional hub. Developments within this region therefore point toward the evolution of a multi-hub system, in which several large hubs vie for intraregional and long haul traffic (Bowen 2000, 38). This is similar to the competition among Tokyo, Taipei and Seoul in Northeast Asia.

However, privatization of MAS has not yielded the textbook benefits of greater efficiency and competitiveness. Instead the huge losses sustained during its foray into privatized hands have caused the government to resort toward re-nationalization and a renewed effort to improve the competitiveness of the national carrier. The opening of a LCC in the country has forced MAS to be more competitive. Similarly, the liberalization of the lucrative Kuala Lumpur-Singapore route will also continue to increase the competitive pressures on MAS. While the new management has managed to turn MAS operations back to profitability, it has still a long way to go in terms of competing against other national carriers such as Singapore Airlines and Thai Airways as these two airlines have formed an alliance with the leading global airlines alliance group in the world.

The promotion of KLIA as a regional hub that is able to gain from ASEAN open skies will require the government to review its strategy to build a regional cargo hub at Senai. Instead, it should refocus on the development of KLIA as a regional hub for both passenger and cargo traffic. However, although infrastructure investment is important, it is not sufficient to guarantee the realization of KLIA as a regional hub. Instead, it is imperative for the national carrier, MAS to join a strategic global alliance group to improve its traffic feed. At the same time, the promotion of tourism in the

country, especially to non-ASEAN countries has to focus on a distinctive product appeal that will enable it to differentiate its tourism products from the regional competitors.

Ultimately, it is not just the liberalization of the aviation sector alone that is needed for the development of KLIA as a regional hub. Instead jockeying for regional hub status from KLIA against established hubs in Singapore and Bangkok and the increase in supply in each of these airports implies a greater need than ever for an integrated ASEAN market and this can only come about with the realization of the ASEAN community. Malaysia's dependence on the external economy and its relatively small domestic economy (26 million in 2006) as compared to some of its ASEAN neighbors such as Indonesia and Thailand makes it even more dependent on the region for scale economies than others. Consequently for Malaysia, it is the realization of the ASEAN community that is of primary importance for its economic growth and for the attainment of its goal to be a regional hub for passenger and cargo traffic.

Appendix 1: Specific Incentives and Funds for the Tourism Sector in Malaysia

1. Tour operators who bring in at least 500 foreign tourists in the assessed year through group inclusive tours that is certified by the Ministry of Tourism are also exempted from tax on income earned from the business of operating tours. The tour operators need to be licensed under the Tourism Industry Act 1992;
2. Double deduction for expenditure incurred by hotels and tour operators for overseas promotion is another incentive provided for this industry;
3. Double tax deduction is also allowed for expenses incurred in training of hotel staff and tour operators to upgrade their skills levels, as approved by the Tourism Ministry;
4. Organizers of international trade exhibitions/conferences in Malaysia are also eligible for tax exemption on income earned from organizing international exhibitions that are approved by MATRADE and the organizers of the international exhibition have to bring in at least 500 foreign trade visitors per event;
5. Apart from preferred tourist goods that are exempted from import duties, import duty exemptions are also granted to branded ready-made clothes and leather goods with an import value of not less than RM200 per unit;
6. Service tax exemption is granted to two-star hotels and those of a lower category that have at least 20 rooms except for hotels in Penang, Johor Baru and Kuala Lumpur that should have at least 50 rooms;
7. Two special funds namely the Special Fund for Tourism and Infrastructure were launched in 2002 in order to stimulate private investment, and the upgrading of tourism products.

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