Malaysian Aviation Commission
Suruhanjaya Penerbangan Malaysia
MAVCOM

COMMENTARY ON GOVERNMENT ASSISTANCE TO THE AVIATION INDUSTRY AMIDST THE COVID-19 PANDEMIC

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This Commentary provides the Malaysian Aviation Commission's ("MAVCOM") initial views and position on the Government of Malaysia's ("GOM") announced and possible future assistance to the aviation industry.

The global aviation industry has suffered immensely from the COVID-19 pandemic. As a result, airlines worldwide, including in Malaysia, are reported to have sought financial support from their respective governments. MAVCOM recommends that as the GOM considers these requests, it should bear in mind that its main policy objectives should be to maintain essential air connectivity (most notably Public Service Obligation routes) and protect vulnerable parties such as the 50,000 employees in the aviation sector and Malaysian consumers more broadly, rather than propping up the commercial performance of airlines.

MAVCOM submits the following salient points as its views and position:

GOM assistance should be the last resort: given the pressures on the GOM's fiscal resources, MAVCOM recommends that industry operators must exhaust other options first, including assistance from their respective shareholders, before approaching the GOM, which should act only as a lender of last resort for the industry.

Given the risks involved, good governance matters: while assisting industry players may help provide relief to distressed parties, the measures may also risk moral hazard and the wastage of public funds. Any assistance measures must be carefully structured to ensure their intended use and be focused on policy objectives of protecting employees and consumers, as well as, maintaining essential air transport services. MAVCOM advocates for principles of good governance to be strictly adhered to by the GOM, and indeed imposed on any recipient of government assistance, to prevent the misuse of public funds.

Non-fiscal policy and regulatory responses are available: the GOM should consider non-fiscal policy responses, most notably by clarifying and relaxing ownership rules to allow industry players to access a wider range of funding sources from domestic and international capital markets, while accompanied by effective regulatory oversight to prevent the abuse of these rights.

Industry consolidation via mergers must safeguard consumer interests: any step towards industry consolidation, in the name of keeping firms afloat, must adhere to the merger control provisions in Act 771 to safeguard industry and consumer interests. The immediate relief such consolidation may provide must be balanced against any risks to the long-term health and competitiveness of the aviation services market.

FISCAL RESPONSE

Government Assistance Should Be the Last Resort

The GOM's fiscal resources are under considerable pressure given the expenditure required to fund the public health system and assist financially distressed households and small businesses. Hence, **MAVCOM recommends that the GOM acts only as the lender of last resort** to the aviation industry players, similar to how Bank Negara Malaysia is to Malaysian financial institutions. As such, the GOM should carefully evaluate whether industry players, including airlines, have genuinely sought government assistance only as a last resort after exhausting all the other alternatives before deciding to offer financial assistance.

Caution Required Given Moral Hazard and Risks

In doing so, the GOM must also be aware of the **trade-offs inherent in the decision to offer financial assistance or otherwise**. Offering financial assistance, if done haphazardly, may risk moral hazard and prolong inefficiencies by shielding the industry players from taking difficult but necessary measures. Given that the GOM, via its investment companies, has already expended significant resources in supporting Malaysia Airlines for the last 20 years, and that any assistance is not likely to yield positive returns, there may be little appetite to further do so for Malaysian carriers in general.

Conversely, **allowing failing players to collapse will also have negative consequences** such as the loss of jobs (passenger airlines employ over 20,000 staff), reduced international connectivity (the reduction or loss of air services to key aviation markets such as China, Indonesia, and India), and disrupted supply chains (air cargo accounts for around 30% of Malaysia's international trade by value). Any decision to provide financial assistance must be accompanied by rigorous cost-benefit analysis to ensure that an optimal solution is reached.

Given this backdrop, MAVCOM views that **any financial assistance should be carefully structured** to ensure that it is not treated as windfall gains for airline shareholders. More targeted options, instead of outright bailouts, that reduce the risk of moral hazard and channel money towards their intended uses are available, such as:

- Funding measures undertaken by airlines to combat the spread of COVID-19, including flight disinfection, and medical and hygiene equipment
- Subsidies and incentives for airlines to retain employees on their payroll
- Temporarily waiving government-imposed charges such as air traffic control charges, airport departure levies, and industry development levies
- Facilitating public or private loans with subsidized interest rates
- Targeted tax exemptions and subsidies for services transporting essential goods and people

In deciding the form of financial assistance, the GOM must focus on its primary policy objectives. **MAVCOM suggests that the GOM prioritize measures that mitigate the loss of employment, minimize consumer losses, and support the continuation of essential air connectivity.**

Good Governance Matters

If the GOM decides to provide financial assistance to the aviation industry players, MAVCOM recommends for the GOM to adhere to the following principles of good governance to prevent any misuse of public funds. These principles are enforced by the EU and the US when they provide financial assistance to ailing firms:

1. **Non-discriminatory** with the assistance made available to all domestic players regardless of their ownership status.
2. **Well-targeted** to effectively remedy the identified problem. Financial assistance must have a clear purpose, scope, considerations, and limits.
3. **Proportionate** with a **sunset clause** to ensure that the financial assistance is not beyond what is required.
4. **Accountability** with the financial assistance having clear governance structure and recipients being audited by independent auditors.
5. **Transparency** with the details of the financial assistance made public. Recipients should also publicize their operational status and performance, as well as, their efforts to pay back the financial assistance received.
6. **Minimizing any potential negative effects,** including distortions to the competition process in the market.

NON-FISCAL POLICY AND REGULATORY RESPONSES

Clarifying and relaxing certain aviation-related policy requirements may also provide some relief to airlines without fiscal costs. Most relevant would be the relaxation of the policy on ownership ("ownership liberalization") for the aviation sector. Other policy requirements, such as those on slot usage, may also be temporarily loosened to reduce the burden of compliance on the airlines.

Ownership Liberalization for Aviation Industry Players

Ownership liberalization is not an unusual policy response during periods of crises. The GOM had already undertaken ownership liberalization for the telecommunications industry during the 1997 Asian Financial Crisis. Then, the GOM had relaxed the foreign ownership restriction from 30% to 61%, then to 70% for network service providers. The foreign equity ownership liberalization has resulted in Telenor, a Norwegian company, having equity shares in Digi Telecommunications, Malaysia's third-largest mobile player. Currently, the GOM allows up to 100% foreign equity ownership for application service providers.

There are also examples of liberal ownership requirement policies for the aviation industry in other countries. Australia and India allow for their domestic airlines to have up to 100% foreign ownership. Meanwhile, Chile does not impose any restrictions on foreign ownership of its airlines so long as their principal place of business is in Chile. Furthermore, in line with the EU's Single Market objective, Lufthansa, Germany's flag carrier, is allowed to own Austrian Airlines, Brussels Airlines, and Swiss International Air Lines, which are the flag carriers of Austria, Belgium, and Switzerland, respectively.

MAVCOM recommends for the GOM to adopt a similar ownership liberalization policy for the aviation industry as this allows industry players to access a wide range of funding sources from the local and international capital markets. This could address both the capitalization and liquidity challenges that industry players and especially airlines are currently facing. MAVCOM emphasises the importance for such ownership liberalization to be accompanied by effective regulatory oversight to ensure players are not abusing their liberalization rights.

Mergers Must Adhere to Act 771

MAVCOM is aware that shareholders, in assessing their options, may consider industry consolidation via mergers, especially during crises such as the current pandemic. MAVCOM notes that even before the pandemic, airlines such as Malaysia Airlines and AirAsia have been reported as engaging in discussions over a potential merger. The current pandemic may provide further impetus for such a merger to proceed.

MAVCOM reminds industry players that their merger transactions are subject to the merger control law as incorporated into Act 771 and that they must submit their proposed mergers to MAVCOM for approval. In general, any merger that may substantially lessen competition in any aviation market—such as air passenger services and ground-handling—is prohibited by law.

A merger between two domestic airlines will foreseeably result in a high concentration of the Malaysian domestic aviation market. The merged entity will likely hold a monopoly status in many domestic routes. **MAVCOM is concerned that such a merger could have the unintended consequence of distorting the market in the long term.** This could have negative effects on Malaysian consumers as they may experience higher airfares, reduced frequencies and choices, and deteriorating service quality due to the lower degree of competition.

Strict Conditions for Failing Firm Defence

Merging parties may appeal to the "failing firm defence" in justifying their proposed merger transaction amidst the COVID-19 pandemic. In simple terms, they may claim that their firms are failing and would exit the aviation market, and thus, the competition that they provided would be lost anyway.

MAVCOM will strictly assess the merits of any such claim to ensure that parties are not abusing the law. Factors under consideration include the ability of the alleged failing firm to meet its financial obligations in the near future; the existence of any serious prospect of reorganising the business; the likelihood of the alleged failing airline to exit the market within the near future (in the absence of the merger); and the existence of any less anti-competitive alternative to the merger in question.

Concluding Remarks

MAVCOM recognises that aviation industry players are facing unprecedented challenges arising from the COVID-19 crisis. MAVCOM urges the GOM to carefully consider its options in assisting the aviation industry to minimize or avoid undesirable side-effects on the long-term health of the aviation services market.

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