



ICAO SSC status could more than clip Thai carriers' wings



Highlight

- One of the recent events creating turbulence in the Thai aviation industry was an early warning that Thailand's air safety credentials could be downgraded by the International Civil Aviation Organization (ICAO). EIC believes a red flag for Thai aviation safety could create a ripple effect causing international aviation agencies to reevaluate the safety of Thai aviation facilities.
- If Thailand's air safety rating is downgraded by international aviation agencies, Thai airlines will face the loss of goodwill, higher operating costs, and increasing competition from foreign carriers. Charter carriers will lose out as their operating licenses are issued on a case-by-case basis. Full service airlines and medium haul low cost carriers will experience setbacks in their growth plans from the inability to establish new routes or increase their flight frequencies, while domestic low cost carriers will remain least affected. In addition, it could take at least 4 years and require the efforts of the public and private sectors to get Thailand's air safety credentials reinstated.

ICAO's warning of Thailand's potential SSC status is just the beginning. A red flag for its air safety credentials could lead to a string of reevaluations of Thai aviation facilities across the international community. Following the International Civil Aviation Organization (ICAO)'s recent audit of the Thai Department of Civil Aviation (DCA) in late January 2015, Thailand was notified that its air safety rating could be branded with "Significant Safety Concern (SSC)" status. The early warning has led to Japan and South Korea's bans on Thai chartered flights (temporarily lifted during April and May for Thailand's high travel season), as well as increased inspections of Thai registered aircraft by the international aviation community. EIC believes that these immediate responses are just the tip of the iceberg and that ICAO's red flag for the Thai DCA will spark the interest of other international aviation agencies, namely the United States Federal Aviation Administration (US FAA) and the European Aviation Safety Agency (EASA), to conduct their own assessments. Past cases have shown that although the decisions of each aviation agency are entirely separated, the decision of one usually triggers audits from others due to similar assessment criteria. One notable example has been the US FAA's downgrade of the Philippines' air safety rating in 2008, which led to an ICAO audit and downgrade of the Filipino aviation authority in 2009 and to the EU, Japan, and South Korea banning all Filipino carriers from entering their airspace in 2010.

As in the case of Indonesia, even if a country has avoided an ICAO downgrade, it could still be downgraded by the US FAA and EASA. EIC believes that despite Thailand having successfully avoided being listed on the ICAO list of SSC status holders, the Thai aviation industry is yet to see clear skies as evident in the case of Indonesia. Although Indonesia currently does not hold SSC status, the country is still listed as a Category 2 country¹ by the US FAA and most of its carriers are banned from entering EU airspace.

Any downgrades will immediately create a loss of goodwill. Continuing to learn from the case of the Philippines, we saw the potential immediate effect an air safety downgrade can have on airlines. Under the EU blacklist, Philippine Airlines saw a loss of its goodwill after European authorities warned its locals not to patronize the carrier, even though the carrier did not provide service from the Philippines to the EU. Moreover, the flag carrier began to lose its international market share to foreign carriers, as well as low to cost carriers looking to compete with it leg on leg on regional routes. The national carrier saw slower international passenger growth of less than 2% CAGR during 2010 – 2013 when compared to pre-downgrade growth of at least 5% CAGR during 2005 – 2008. Philippine Airlines' international passenger share fell over 9 percentage points during the downgrade period from 33% in 2005 to 24% in 2013. This did not come as a surprise as safety is listed among the top choice attributes that customers consider when selecting a carrier. For Thailand, the loss of goodwill will further put Thai full service carriers at a disadvantage with emerging Middle Eastern competitors, which in the past few years have positioned themselves by offering premium services in an acceptable price range.

If downgrades and bans are prolonged, higher operating costs and limited growth will worsen airline competitiveness. Loss of goodwill may not be the only impact a downgrade in a country's air safety rating may have on its carriers. During the downgrade period, airlines will not be allowed to expand their current level of services, meaning a carrier may not be able to increase its frequency on existing routes or establish new routes to countries in which it has been blacklisted. The financial impacts from limited business growth are evident in the case of the Philippines, with Philippine Airlines seeing stagnant revenue growth of 0.3% CAGR during 2008 – 2013. Aside from lower revenue generation, the national carrier also began to see higher operating costs from higher aircraft lease rates, more stringent maintenance covenants, and surges in insurance premiums, which led to the airline's lower profitability.

Reinstatements of air safety credentials could take at least 4 years and require joint efforts from the private sector and government. Cases of former Category 2 or SSC status holders show that upgrades or reinstatement of a country's air safety rating are possible. However, most upgrade takes time, as can be seen in the case of reinstatement to Category 1 of the Philippines, Israel, and India taking at least 4 years on average. However, EIC believes that relying on the government alone may not be as effective if the private sector does not take part in helping uplift its country's air safety rating credentials. The case of the Philippines showed that involvement of the private sector does pay off. For instance, in 2012 Philippine Airlines signed a contract with a US-based aviation consultant to train and provide technical assistance to CAAP, its national aviation authority, as well as provide a

1 A "Category 2" status implies that the state aviation authority does not meet the standards of those set by the ICAO. With this status, air carriers operating flights to the US will not be permitted to initiate new service and are limited to the current levels of existing services to the US until the country has been reinstated to "Category 1".

Code sharing arrangements between the country's carriers and US carriers will be suspended and extra inspection will be imposed on existing flights to the US.

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“roadmap” to the state authority to ensure it complies with safety standards set by the ICAO. The roadmap included drafting more comprehensive inspector handbooks and technical guidance, as well as updating Philippine Civil Aviation Regulations (PCARs). The consultation was provided to the CAAP free of charge as the flag carrier absorbed all contract costs. The decision helped uplift Philippine safety standards across the aviation industry, rather than Philippine Airlines itself. As a result, the ICAO lifted the Philippines’ SSC status in 2013 just one year after the contract was signed and Philippine Airlines saw a more than 36% surge in revenue between 2013 and 2014.

A boost in confidence is likely to be seen if the corrective action plan proposed by the Thai government and its airlines is able to boost Thai air safety standards prior to a downgrade. Since Thai authorities received early warning of Thailand’s potential air safety rating downgrade several correct measures have been taken to prevent the country from earning SSC status. One of Thailand’s early initiatives was the DCA’s enlistment of private sector and industry experts to help formulate the country’s corrective action plan which will be proposed to the ICAO in July. After that, all 41 carriers currently operating in Thailand are expected to be issued with new certification complying with ICAO safety standards. Additionally, Thai officials have identified 7 carriers that are able to handle hazardous goods in and out of Thailand. As for the private sector, Thailand’s leading four airlines (Thai Airways International, Bangkok Airways, Nok Air, and Thai AirAsia) have pooled their resources and plan to raise 17 million baht in hiring foreign aviation consultants to train and provide technical assistance to the Thai DCA and Thai registered airlines. With ICAO’s final report coming and the US FAA audit starting in July, Thailand will have to wait a while to see if all these efforts paid off.

Implication

- **Thailand should be well aware of the potential impacts of a downgrade in its air safety credentials, but not be discouraged.** The case of the Philippines showed that upgrades in a country’s air safety rating are achievable, but may take time. For the Philippines, it took 4 years for the ICAO to lift its SSC status and 6 years for the US FAA to reinstate it to “Category 1” status. As a result, EIC believes it is of the utmost importance that the Thai DCA makes a great effort to resolve this issue as quickly as possible.
- **If air safety ratings are downgraded, Thai airlines will face a loss of goodwill, higher operating costs, and increasing competition from foreign carriers.** Apart from the potential loss of goodwill, passengers, and revenue, Thai carriers can expect an increase in costs from higher aircraft lease rates, more stringent maintenance covenants, and surges in insurance premiums. The industry will likely see increased competition from foreign carriers that may launch new routes to capture underserved passengers travelling to and from Thailand. Thai carriers may also lose personnel to foreign counterparts looking to boost their own manpower. Out of all the sub-segments in the airline industry, charter carriers will lose out the most as their operating licenses are issued on a case-by-case basis, while full service airlines and medium haul low cost carriers will experience some setbacks in their growth plans from an inability to establish new routes or increase

flight frequencies. Domestic low cost carriers will remain least affected.

Expect minimal effects from a downgrade in Thailand's air safety ratings on airline customers, Thai airports, and the country's tourism industry. We expect airline customers to continue to benefit from lower ticket prices as airlines aim to secure their ridership and competitiveness. Thai airports and the tourism industry will be minimally impacted as there will be other carriers waiting to serve airline customers. For instance, both the Philippines and Indonesia continued to see an increasing number of inbound international tourists despite their air safety downgrades. Indonesia saw an average of 10% annual growth in European tourist arrivals during the period of EASA's ban on its airlines.

Figure 1: ICAO and US FAA have similar aviation safety oversight audit assessment criteria

	International Civil Aviation Organization (ICAO): Universal Safety Oversight Audit Programme	US Federal Aviation Administration (US FAA): International Aviation Safety Assessment Program
Audit assessment criteria	<ol style="list-style-type: none"> 1. Primary aviation legislation & associated civil aviation regulation 2. Civil aviation organizational structure 3. Personnel licensing activities 4. Aircraft operations 5. Airworthiness of civil aircraft 6. Accident and serious incident investigations 7. Air navigation services 8. Aerodromes 	<ol style="list-style-type: none"> 1. Primary Aviation Legislation 2. Specific Operating Regulation 3. State Civil Aviation System and Safety Oversight Functions 4. Technical Personnel Qualification and Training 5. Technical Guidance 6. Certification Obligations 7. Surveillance Obligations 8. Resolution of Safety Issues
Negative end result	Significant Safety Concern (SSC)	Category 2

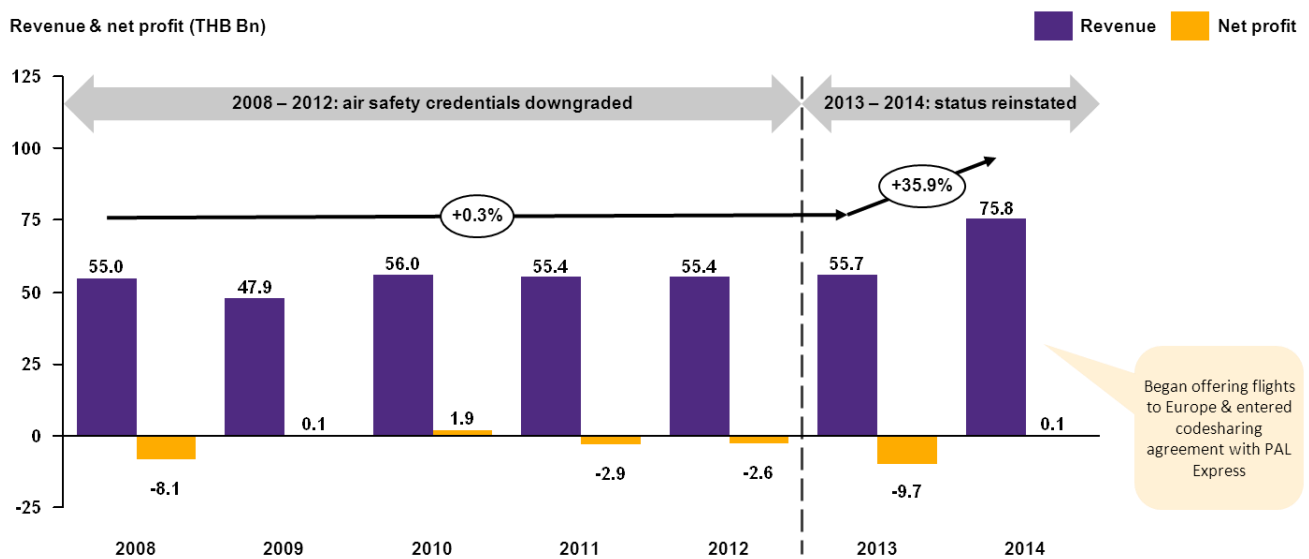
Source: EIC analysis based on data from ICAO and US FAA

Figure 2: The Philippines' failure to meet safety oversight standards set by the US FAA and ICAO led to the EU's ban of its carrier

Year implemented	Implementing body	Initial findings	Actions taken	Year removed
2008	United States Federal Aviation Administration (US FAA)	Failure to comply with international safety standards set by the ICAO, in part due to deficiencies in: <ul style="list-style-type: none"> – Integrity of the issuance of certificates (ex. operating/ compliance certificates or airworthiness certificates) – Qualification and training of inspectors and other critical technical personnel – Conduct of safety oversight functions – Record-keeping, etc. 	Downgraded PH civil aviation from Category 1 to Category 2 status	2014
2009	International Civil Aviation Organization (ICAO)	88 safety concerns involving 278 out of the 987 audit protocols, indicating a 28% "lack of effective implementation" score in aviation safety	PH civil aviation was identified as a Significant Safety Concern (SSC)	2013
2010	European Aviation Safety Agency (EASA)	"Lack of safety oversight measures." Bases: <ul style="list-style-type: none"> – US FAA's 2008 audit – ICAO's 2009 audit 	PH-licensed carriers were blacklisted from EU airspace	2013

Source: EIC analysis based on data from Presidential Communications Operations Office, United States Federal Aviation Administration, press search cited by Wallace Business Forum

Figure 3: Philippine Airlines saw stagnant revenue growth and declining profitability during the downgrade period



Source: EIC analysis based on data from CAPA

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