

The Impact of Price Ceiling and Price Floor Implementation Towards Indonesia Scheduled Commercial Air Transport

A G Fabianto^{1*}, Tito Warsito², Aditya Wardana³, Novembriani Irenita⁴, Yulianti Keke⁵

^{1,2,3,4,5} Institut Transportasi dan Logistik Trisakti, Jakarta, Indonesia

*Corresponding author: Gerald.fabianto@gmail.com

Abstract, Along with the increasing ticket price of air transport and monopolistic market that emerge in Indonesia aviation industry, the government implements price ceiling and price floor regulation to control air transport ticket price based on airline class of services. The goal of price ceiling and price floor regulation is to maximize economic welfare. With this regulation the airline still retains its freedom to manage prices and capacities as long as still in the range of price ceiling and floor. This paper aims to describe the purpose of price ceiling and price floor implementation and the impact towards airlines, consumers and another mode of transportation. Author uses descriptive method with qualitative approach to describe the problem.

Keywords: price ceiling and price floor regulation, impact towards airlines, ticket price

1. Introduction

Transportation has an important and strategic role to support, stimulate, and facilitate all aspects of life. Air transportation becomes more important for Indonesia since it is the world largest archipelago that stretches. Air transportation is a kind transportation facility that connects all areas in Indonesia in the fastest way[1]

Since deregulation in 1999, aviation industry in Indonesia has significantly increased in terms of the amount of airlines that operate in the market and passengers growth[2]. With the increasing amount of airlines that operate it, will create intense competition especially in the presence of newly adopted concept of low cost carrier in Indonesia that widely used by many airlines. Full service airline needs to innovate to find the correct choice of strategy to be able to compete and hold its ground[3]. The airline is attacking traditional full-service airlines by offering lower fares (low costs per passenger seat are a precondition). Additional factors are a large concentration of market share, new market entrants, exit barriers and price leadership[4]. These conditions lead to unfair competition and price wars in domestic market, resulting approximately nine airlines have to stop their operation[2]. There are some airlines who adopt LCC concept with profit oriented but not putting safety as consideration that resulting many accidents, incidents and gives negative image in safety standard of Indonesia aviation industry[5].

To avoid and prevent any further price wars and unfair competition the government implements price regulation to keep fair competition and stable growth in aviation industry. At first this regulation serves as tariff reference and then being evaluated and changed into price ceiling and price floor[6]

2. Literature Review

2.1 Historical Background in Air Transport Policy Related to Tariff

Under the former first president of Indonesia Soekarno, air transportation was fully controlled and supervised by the government. Indicated by only 2 airlines served different routes as given by the government. As time goes by under several former presidents of Indonesia, air transportation industry has been deregulated in certain aspects related to aircraft operation, safety and security, maintenance and business practices. Deregulation resulted

numerous airlines operated in Indonesia and has made competition more intense, thus pricing became more predatory and ensuing tariff war indirectly eliminated other airline companies as well another mode of transportation companies.[6]

2.2 Air Transport Tariff Policies Development

The main function of tariff regulation is to secure the economic for the benefit of the travelling public and to eliminate the hazards of free competition. In addition, a tariff can have a significant influence on airlines, travelers and regulator. For the airlines, a tariff that is too low may jeopardize the sustainability of an air carrier's operations, whilst a tariff is too expensive may make it unaffordable for travelers to travel. For the regulator, a tariff is a means to regulate the balance of the sustainability of airlines operations and to guarantee that travelers can afford the price for the benefit of the travelling public. For these reasons, tariffs must be carefully regulated by the regulator.[6]

Tariff in air transportation is being strictly controlled since old order regime under President Soekarno until now. In Ministerial Decree No. 6 1994, Ministry of Transportation controls air transport tariffs in remote area . This policy plays a role as reference tariff for determining air transport ticket price in remote area. With this regulation, airline doesn't have the authority to determine its own price, every single route in remote area should be charged according to reference tariff. And for the route that is not listed, airline needs to file air transport tariff plan for each route to DGCA.

In 2002, the policy also applied to economy class in scheduled commercial domestic flight in Ministerial Decree no 9 2002. With this policy determines ticket price based on tavel distance for each passanger, so farther route would be cheaper in terms of base price multiplier. Formulation of the tariff is shown in the figure1. As you can see, base price for each passanger/kilometre is cheaper depends on the distance.

In 2005 Ministry of Transportation reviews and evaluates the previous Ministerial Decree No 9 2002. Therefore Ministerial Regulation No 36 2005 is out, this regulation plays a role as reference tariff but also prevent unfair regulation and protect consumers affordability or purchasing power. This regulation also serves as a tool for controlling scheduled commercial airline and towards their operation. Scheduled commercial airline before setting ticket price should consider security and safety of each flight and ensure fair competition between airlines.

2.3 Civil Aviation Act 2009

Indonesia aviation industry is taking a huge step by the implementation of Civil Aviation Act (CAA) in 2009. CAA regulates various aspect related to aviation, from sovereignty in air space, aircraft production, peration and airworthiness of aircraft to aviation safety and security, aircraft procurement, aviation insurance, the independence of aircraft accident investigation, and the licensing of aviation professionals, scheduled as well as non-scheduled air transportation, airline capital, the ownership of aircraft, aircraft leasing, tariffs,the liability of air carriers, air navigation facilities, airport authorities and services, and law enforcement related to air transportation..[6] According to Civil Aviation Act as mentioned above, it regulates class of services in scheduled commercial air transport, the classification is shown on the table below:

Airline Class of Services	Price Ceiling	Price Floor
Full Service	100%	35% from Price Ceiling
Medium Service	90%	35% from Price Ceiling
No Frills	85%	35% from Price Ceiling

Table 1 Class of Services according to CAA

Full service provides maximum service standard, while medium service provides limited services compared to full service and the last one no frills provides no service for free, it means service is available but you need to pay for it. Under the CAA of 2009 article no. 126-127, The Minister of Transportation should determine tariff ceiling of economy class in scheduled commercial air transport. The tariffs set by the Minister of Transportation has an upper limit which takes into account factors such as the need to protect consumers and prevent unfair competition. On the whole, Indonesia's aviation regulations protect consumers by indirectly specifying a lower limit for the determination of tariffs, and at the same time the tariff regulations also prevent under pricing practices by air service providers that aim to squeeze competing carriers out of the market[6]

2.4 Upper Limit and Lower Limit Cap of Airline Tariff

Price cap regulation has been adopted in some industries. Ultimate goal of price regulation is to maximize economic welfare and to limit carriers to a reasonable return while allowing economically efficient prices, economics recognize that welfare is maximized when 'first best' prices (prices equal to marginal costs) are charged[7]. The function of price cap is different than reference tariff that we discussed earlier, with price cap being implemented airline company retains its freedom to determine its own ticket price as long as in the range of price floor and price cap.

Price cap should be implemented as a mandatory under the provision of CAA, meanwhile CAA doesn't mention regarding price floor in scheduled commercial domestic air transport. But as mentioned above price floor is regulated to ensure fair competition and to protect consumers. According to the newest policy that comes out in 2019 Ministerial Decree of Transportation No KM 72 2019 and Ministerial Regulation of Transportation No PM 20 2019, Directorate General Civil Aviation (DGCA) as a regulator has the authority to control and supervise related to airfare to provide consumers protection from unaffordable tariff and providing fair competition to the industry itself.

3. Research Method

3.1 Type of Research

To analyze the problem of this research and the impact of price cap regulation, author uses descriptive method with qualitative approach. Descriptive research is used to describe characteristic or current events[8]. The purpose of descriptive method is to make description or overview systematical and factual facts and the correlation of the events. This research first describes mechanism and purpose of price regulation for air transport. Next it discusses the impact of price cap regulation to the airline, next it discusses the impact of price cap regulation to consumers and the last one is the impact of price cap regulation to another mode of transportation.

3.2 Research Location

The location of this research is located in several places :

- Head Office of Indonesian Consumers Foundation
- Directorate of Air Transport Office
- Merpati Training Centre Office
- Citilink Office

3.3 Data Source

Author interviewed several people to collect primary data, the first one is executive chairman of Indonesian Consumers Foundation, the second one is section chief in directorate of air transport, the third one is former CEO of Merpati Nusantara Airlines.

3.4 Data Analysis Technique

In analyzing the collected data, the researcher applied the steps of qualitative data analysis proposed by [9] that consists of ; data reduction, data display and conclusion drawing/verification

- Data Reduction is the process of reducing the data occurring repeatedly. Data reduction is the process of selecting, focusing on the important things, simplifying, abstracting and transforming the data that appear in transcription[9]
- Data Display “Looking at displays help us to understand what is happening and to do something-further analysis or caution on that understanding”, this statement is what has been stated by [9]
- Conclusion Drawing / Verification is the last step of qualitative data analysis [9]

3.5 Data Validation

The results of analysis were tested for reliability and validity through source triangulation. Triangulation is defined as technique of collecting data by combination of some different data sources[8]. The triangulation sources in this research were from different perspectives and position of the informant like airline operator, regulator of air transport and from consumers (represented by consumers foundation).

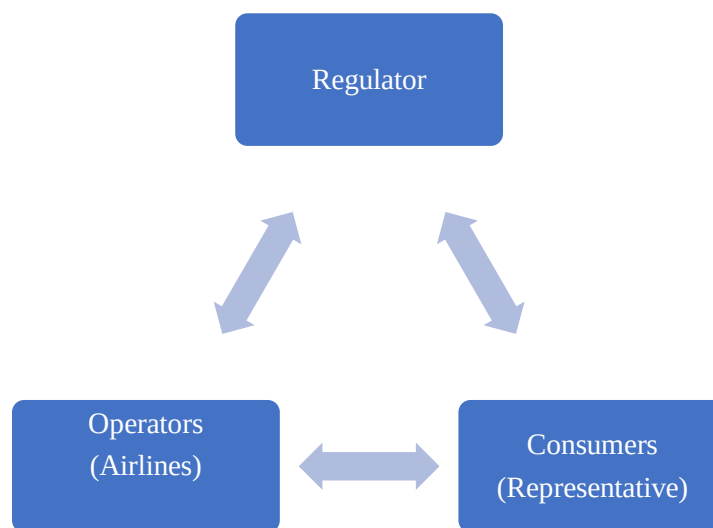


Figure 1. The Triangulations

4. Discussion and Result

Indonesia aviation industry is basically overregulated in terms of numerous policies implemented in every aspect of air transportation. In this research regarding price cap and price floor, the function of this regulation is to control and supervise air transportation tariff based on class of services of the airlines as shown on description below ;

JAKARTA	JAKARTA (HALIM P)	130.000	46.000
JAKARTA	JAMBI	1.372.000	480.000
JAKARTA	JAYAPURA	5.473.000	1.916.000
JAKARTA	KAIMANA	4.318.000	1.511.000

Table 2 A few example of Price Ceiling and Price Floor in Several Routes as Documented in Ministerial Decree No KM 72 2019

Airline Class of Services	Price Ceiling	Price Floor
Full Service	100%	35% from Price Ceiling
Medium Service	90%	35% from Price Ceiling
No Frills	85%	35% from Price Ceiling

Table 3 Class of Services according to CAA

Basically as you see on the table above, airline needs to adjust ticket price based on class of services, on this example for full service airline, the maximum ticket price that can be applied for route of Jakarta – Jambi is Rp 1.372.000 (100%) and the minimum ticket price is Rp 480.000 (35%). Next for medium service airline the maximum ticket price is Rp 1.234.800 (90%) and the minimum ticket price is Rp 432.180 (35%), meanwhile for no frill service airline the maximum ticket price is Rp 1.166.200 (85%) and the minimum ticket price is Rp 408.170 (35%).

Indonesia scheduled domestic air transport market has become classic duopoly market, owned by two major airline groups, Garuda Group and Lion Group collectively owned 84% marketshare. Therefore no matter how expensive the airline ticket price would be consumers don't have a choice in terms of selecting which airlines to choose. Demand on any given route and in any given segment is highly variable, demand varies by season, day of the week, hour of the day and demand is different among the different customer segments —e.g., business travel tends to be some- what lower in August while leisure travel tends to peak in August.[7]

There are many separate consumer segments: some prefer first class services, others prefer coach; some are highly price sensitive (e.g., retired individuals), some moderately price sensitive (family vacations)[7]. In Indonesia majority of passenger comes from state civil apparatus, employees of state-owned enterprises and employee of private companies. These customers are not using their own money but the tickets are paid using company funds, thus not categorized as price sensitive

So airlines that operate in Indonesia need to adjust based on class of services, airline still retains its freedom to determine ticket price as long as still in the range of price ceiling and floor. This regulation is reviewed and evaluated in periodic time as mandatory of Civil Aviation Act.

There are many benefits or functionality of price ceiling and price floor regulation towards airline businesses, consumers and another mode of transportation. The main purpose of price ceiling and price floor implementation is to provide healthy environment for sustainability of the airlines, another mode of transportation and the affordability of the consumers itself.

For airline businesses the implementation of price ceiling and price floor has given a smaller or newly established airlines to compete in fair condition especially in duopoly market whereas the characteristic of it is there are higher barriers to entry. This regulation also serves as a tool to prevent or minimize predatory pricing that can damage the industry and affect the sustainability of other airlines. This regulation is also formulated with adequate profit margin for the airlines to keep growing and expand their businesses. Furthermore, this regulation also protect and ensure the safety and security of airlines operation by putting the minimum price

that can be charged to the consumers, thus airlines will have enough revenue to accommodate the highest quality of maintenance and aircraft operations.

Meanwhile for consumers the implementation of price ceiling and price floor has given plenty of benefits like protecting the affordability or purchasing power of consumers, especially in island country like Indonesia whereas air transportation is considered as primary needs to move from one point to another. Generally in any industry, the market itself determines the price of a product or service depends on the demand. In aviation industry demand is highly variable resulting in significantly increased or decreased ticket price. In peak season where the demand is high ticket price will increase to certain level and it will affect consumers buying power. With this regulation price increase in peak season will stay in reasonable price level and it will give a good impact towards consumers affordability. This regulation also serves as a tool to ensure and provide certainty for the consumers that airline has put safety and security as consideration by selling reasonable ticket prices. Due to historical background of how bad air transportation in Indonesia, this regulation seems to give a positive impact towards consumers will to purchase or use air transportation.

Lastly for another mode of transportation, the implementation of price ceiling and price floor has served as a balancing tool for sustainability for each mode of transportation. With this regulation consumers will be segmented towards their affordability and needs. Air transportation will serve as main transportation for those who seek rapid transport, headed for certain destinations or uncharted routes that cant be reached by land or sea transportation, thus the price will slightly be higher than any other mode of transportation. With this regulation other mode of transportation will have its own segmented consumers and serve a different goal towards consumers travelling purposes and needs. Especially in Indonesia where President Jokowi has built many highway or toll road that can connect several regions and can be accessed easily by using cars, it will also give benefit towards regional economy. For region that is crossed by the highway, the traveler tends to visit the region to rest, buy something or literally just looking for tourist attraction and it will increase or drive the economy of the region.

5. Conclusion and Recommendations

The implementation of price ceiling and floor is good, to provide benefit and protect aviation industry especially in domestic market. It also provides benefit to another mode of transportation, all mode of transportation should grow together and synergize to provide a better transportation to connect every single location in Indonesia. To do so government needs to provide a healthy industry in all mode of transportation especially in air transportation. To make a healthy industry in air transportation there are many ways but lets focus related to price ceiling and price floor. First this regulation should be revised and reviewed in periodic time like every 3 months, 6 months or a year. Second of all Indonesian people need to be socialized and educated regarding the implementation of price ceiling and price floor, so they wont protest or upset related to airline ticket price. Third of all airline needs to be more efficient in daily operations and innovate to be able to compete. Fourth of all every stakeholders need to take a part in providing a healthy industry of air transportation, airlines shouldn't take all the blame related to increased ticket price, all stakeholders should take action and make an agreement to provide help so airlines could still grow and operate. Fifth of all government also should take action by providing incentives to airline whether its to reduce value added tax (VAT) or eliminate VAT completely in aviation industry or any other incentives that actually could help airline stands on its ground and survive. Sixth this regulation shouldn't be used as a tool for political interests because aviation industry is really fragile and easily influenced by external factors. If no further action is taken, it wont take long until every airlines stopped serving certain route that's not profitable and it will cause another problem to the society

Reference

- [1] R. Geometry and G. Analysis, "Statistik Transportasi Udara 2017."
- [2] A. Andi Pahlevi, "Anslisis Pengaruh Tarif Penerbangan, Jumlah Penerbangan dan Pendapatan Perkapita Dalam Meningkatkan Jumlah Penumpang," *J. Bisnis Strateg.*, vol. 22, no. 1, pp. 49–66, 2013.
- [3] W. Kuntjoradi and N. Safitri, "Analisis Strategi Bersaing dalam Persaingan Usaha Penerbangan Komersial," *Bisnis Birokrasi, J. Ilmu Adm. dan Organ.*, vol. 16, no. 1, pp. 45–52, 2009.
- [4] O. P. Heil and K. Helsen, "Toward an understanding of price wars: Their nature and how they erupt," *Int. J. Res. Mark.*, vol. 18, no. 1–2, pp. 83–98, 2001.
- [5] D. I. K. Mujiono, "Tantangan Industri Penerbangan Indonesia Menuju ASEAN Open Sky Policy Dadang Ilham K. Mujiono Dosen Ilmu Hubungan Internasional Universitas Mulawarman," *Interdependence*, vol. 3, no. 2015, pp. 56–69, 2015.
- [6] A. Sudiro and K. Martono, "National and International Air Transport Regulations in Indonesia," *IOSR J. Appl. Chem.*, vol. 9, no. 3, pp. 7–22, 2016.
- [7] M. W. Tretheway and W. G. Waters, "Reregulation of the airline industry: could price cap regulation play a role?," *J. Air Transp. Manag.*, vol. 4, no. 1, pp. 47–53, 1998.
- [8] Sugiyono, *Metode Penelitian Pendidikan Pendekatan Kuantitatif, Kualitatif dan R&D*. Bandung: Alfabeta, 2014.
- [9] M. B. MILES and A. M. HUBERMAN, "Drawing Valid Meaning from Qualitative Data: Toward a Shared Craft," *Educ. Res.*, vol. 13, no. 5, pp. 20–30, 2007.