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AGILE Policy Impact Report

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AIR TRANSPORT POLICY: SCORING SIGNIFICANT STRIDES IN LIBERALIZATION

I. Introduction

Philippine aviation policy is derived primarily from Republic Act (RA) 776 or the Civil Aeronautics Act of the Philippines, which was passed in 1952. RA 776 vested upon the Civil Aeronautics Board (CAB) the power to regulate the economic aspect of air transportation, including the issuance of traffic rights to domestic and foreign carriers. The CAB, in the exercise of this power, has been guided by the incumbent administrations' air transport policy, which over the years has been moving towards liberalization. This trend was however, stalled during the Estrada regime, which apparently reverted to a more conservative approach. As a result of the delay in liberalization, its proponents have embarked on a campaign for the resumption of the liberalization policy. This assessment hopes to determine how far the advocacy for the liberalization of the airline industry has progressed, and it hopes to assess the likely impact of such progress on the Philippine economy.

II. Background

President Marcos overturned an existing multiple-airline policy and implemented a single-airline policy by issuing Letters of Instruction (LOI) No. 151 and 151A in December 1973. The LOIs designated the Philippine Airlines (PAL) as the country's sole carrier in both international and domestic operations, while the other airlines - Filipinas Orient Airways and Air Manila, were taken over by PAL. Recognizing that LOIs No. 151 and 151A were inconsistent with RA 776, President Aquino issued Executive Order (EO) 333 in 16 August 1988 revoking the LOIs and the one airline policy, and implicitly pave the way for liberalization. To further promote liberalization, President Ramos built upon the intent of EO 333 and issued EO 219 in 3 January 1995 categorically declaring the country's liberalization policy.

Philippine Institute for Development Studies (PIDS) Research Fellow Dr. Myrna Austria has observed that between 1998 and 2000, air transport liberalization "... brought genuine competition in the domestic air transport industry", which resulted in "...lower airfare, improvement in service and efficiency in the industry in general"[1].

1. **Increase in competition.** EO 333 and EO 219 improved competition in the domestic market (see Appendix 1). They allowed entry of five new players: Cebu Pacific, Air Philippines, Asian Spirit, Mindanao Express and Grand International Airways. Competition quickly changed the industry's market structure. From a total monopoly in 1994, PAL's market share fell to 49% in 1999 (See Table 1). Cebu Pacific and Air Philippines have become PAL's stiffest competitors, with their respective market shares

[1] Austria, Myrna. "The State of Competition and Market Structure of the Philippine Air Transport Industry", Philippine APEC Study Center Network Discussion Paper No. 2000-12. Philippine Institute for Development Studies, November 2000.

growing by 72% and 60% during the period. By 1999, the combined market share of the two reached 46%.

Table 1
Domestic Passenger Traffic Market Shares (%), 1994 – 1999

Airlines	1994	1995	1996	1997	1998	1999
PAL	100.00	95.70	79.39	67.29	55.15	48.94
Cebu Pacific	-	-	6.43	14.72	21.98	24.21
Air Philippines	-	-	4.58	9.91	16.58	21.46
Grand Airways	-	4.30	8.57	5.33	3.34	-
Asian Spirit	-	-	1.03	2.63	2.78	4.80
Mindanao Express	-	-	-	0.13	0.19	0.59
Total	100.00	100.00	100.00	100.00	100.00	100.00

Source: "The State of Competition and Market Structure of the Philippine Air Transport Industry". PIDS
Note: Market shares are measured based on total domestic passenger traffic.

2. **Improvement in airline service.** Stiffer competition improved domestic airline service by increasing airline seat capacity. From 1994 to 1999, the greater number of domestic carriers raised seat capacity by 86% or at a compounded annual growth rate (CAGR) of 13% (See Table 2). This rate could have been higher if PAL did not reduce its fleet size by almost half in 1998. Between 1994 and 1997, seat capacity grew by CAGR of 19.4%.

Table 2
Seat Capacity Per Airline 1994 – 1999

Airlines	1994	1995	1996	1997	1998	1999
PAL	5,670,362	6,773,007	6,044,489	6,323,605	-	5,521,222
Cebu Pacific			561,240	1,348,527	1,462,137	2,303,751
Air Philippines			494,764	1,021,565	1,494,297	2,217,060
Grand Airways		452,400	828,072	657,817	311,030	-
Asian Spirit			112,524	285,051	222,100	447,730
Mindanao Express				22,273	28,588	50,187
Total	5,670,362	7,225,407	8,041,089	9,658,838	3,518,152	10,539,950

Source: "The State of Competition and Market Structure of the Philippine Air Transport Industry". PIDS
Note: There are no available data for PAL for 1998 while 1999 data for PAL is up to 3rd quarter only.

3. **Improvement in airfares.** According to a report written by Dr. Victor Limlingan of the Asian Institute of Management (AIM), airfares for the major routes in the Philippines fell by as much as 48% between 1995 and 1999 due to a 76% average increase in airline capacity (see Table 3).

Table 3
Airline Capacity and Airfares for Major Routes, 1995 vs. 1999

Route	Airline Capacity		% Change	Air Fares		% Change
	1995	1999		1995	1999	
Manila – Cebu	1,378,697	2,389,886	73.34	2,846	2,028	(28.74)
Manila – Davao	579,147	1,021,176	76.32	5,128	2,963	(42.22)
Manila – Zamboanga	196,539	352,040	79.12	5,070	2,651	(47.71)

Source: "Open Skies - Is it Time for the Philippines?", AIM

Cebu Pacific and Air Philippines were also able to offer lower rates (about 29% lower than PAL's) (See Table 4) because they enjoyed lower costs. PAL incurred over $2 billion in debt when it adopted an aggressive expansion program just before the collapse of the Asian economy.

Table 4
Airfare differences (%), 1997 – 1999

	1997			1998			1999		
	PAL vs. CP	PAL vs. AP	CP vs. AP	PAL vs. CP	PAL vs. AP	CP vs. AP	PAL vs. CP	PAL vs. AP	CP vs. AP
Manila – Cebu	33.70	77.20	32.50	30.50	12.50	(13.80)	14.10	14.10	-
Manila – Davao	19.80	184.00	137.00	26.80	14.80	(9.40)	15.00	14.90	-
Manila – Iloilo	16.70	30.00	11.40	27.10	5.40	(17.10)	14.70	15.00	0.30
Manila – Cagayan	11.00		(9.90)	50.30	20.80	(19.60)	21.20	24.50	2.70
Manila – Tacloban	21.90			54.30	19.60	(22.50)	28.10	27.90	(0.10)
Manila – Bacolod	14.90	31.80	14.70	41.00	13.50	(19.60)	15.80	15.60	(0.10)
Manila – Kalibo	27.50	51.00	18.40	17.30	2.00	(13.00)	27.00	15.20	(9.30)
Manila – Zamboanga		37.40		13.00	4.60	(7.40)	25.20	17.60	(6.10)
Average	20.79	68.57	34.02	32.54	11.65	(15.30)	20.14	18.10	(1.58)

Source: "The State of Competition and Market Structure of the Philippine Air Transport Industry". PIDS

Austria cautions that fare improvements, however, may have been due to introductory discounts or cutthroat competition. It may be noted that all airfares, despite liberalization, still increased (in real terms) by at least 12% from 1997 to 1999 (See Table 5).

Table 5
Real Airfare Increases, 1997 vs. 1999 (at 1990 prices) (%)

	PAL	Cebu Pacific	Air Philippines
Manila - Cebu	3.70	12.20	29.20
Manila - Davao	5.50	7.80	65.90
Manila - Iloilo	13.60	14.60	20.80
Manila - Cagayan	15.80	10.90	3.80
Manila - Tacloban	15.10	12.30	-
Manila - Bacolod	14.00	13.60	21.70
Manila - Kalibo	11.60	11.80	27.80
Manila - Zamboanga	17.50	-	27.00
Average	12.10	10.40	24.53

Source: "The State of Competition and Market Structure of the Philippine Air Transport Industry", PIDS

4. **Increase in passenger traffic.** Liberalization also caused a significant rise in domestic travel from 1994 to 1999. From almost 4.5 million passengers in 1994, the availability of flights even in the secondary and tertiary routes, increased passenger traffic by 35.5% to over 6 million passengers by 1999 (See Table 6).

Table 6
Domestic Passenger Traffic, 1994 – 1999

Airlines	1994	1995	1996	1997	1998	1999
PAL	4,495,444	4,735,674	4,448,740	4,602,558	2,968,950	2,980,169
Cebu Pacific			360,574	1,006,820	1,183,431	1,474,649
Air Philippines			256,569	677,967	892,625	1,307,002
Grand Airways		212,866	480,463	364,446	179,826	
Asian Spirit			57,531	179,640	148,409	292,144
Mindanao Express				8,864	10,327	35,918
Total	4,495,444	4,948,540	5,603,877	6,840,295	5,383,568	6,089,882

Source: "The State of Competition and Market Structure of the Philippine Air Transport Industry", PIDS

The liberalization of the domestic routes progressed well but the same was not true with international air transport industry during the Estrada administration. While the CAB was liberal in negotiating bilateral service agreements during the Ramos regime, the board under Estrada launched a "progressive liberalization" policy in 1999 through Civil Aviation Consultative Council (CACC) Resolution No. 001-98. The CACC Resolution did not repeal EO 219, but the absence of implementing rules and regulations (IRRs) for EO 219 gave the Estrada administration an excuse to adopt the progressive liberalization policy. The meaning of progressive liberalization was not really clear but anecdotal evidence suggests that it promoted a more conservative stance.

The more conservative policy resulted in the abrogation of the RP-Taiwan ASA in 1999, which caused major disruptions in tourism and trade between the two countries. The CAB also threatened to abrogate other major ASAs, under the guise of national interest. According to Dr. Limlingan, the abrogation of the RP Taiwan ASA proved costly to the Philippines. Within two months after the abrogation, Taiwan entered into a bilateral open skies agreement with Thailand, which resulted in the diversion of 200,000 tourists from the Philippines to Thailand.

III. Advocacy for the Liberalization of the International Market

The slide to a more conservative approach in the country's airline policy prompted proponents to campaign for a new round of liberalization in 2000. Aimed at allowing a competitive market to thrive in the international airline industry, civil society groups led by the Freedom to Fly Coalition (FFC), pushed for the reinstatement of the RP-Taiwan ASA, the issuance of the IRRs for EO 219 and the availability of flights in other major international routes.

According to Dr. Limlingan, one of the leaders of FFC, the campaign for the liberalization of the air transport industry is primarily aimed at improving tourism in the country. With 98% of the country's tourists flying in, a liberal transport policy would ensure that available supply would result in lower airfares and better services. This, as experienced in the domestic market, should result in higher traffic. A study conducted by McKinsey & Company for the Department of Tourism (DoT), claims that the Philippines, if it adopts the right policies, could see its tourist arrivals figure grow from two million in 2000 to five million in 2010. The report said that this increase would create six million jobs and contribute P17 billion to the Philippine economy. The report mentions the following policy recommendations for tourism to grow:

1. **Use trigger mechanism to immediately increase capacity entitlements.** Trigger mechanisms are provisions in ASAs that enable negotiating countries to automatically

raise their entitlements when a certain traffic level has been reached. These facilitate faster response to increases in demand without the need to go back to the negotiating table.

2. **Negotiate limited open skies agreements with Japan and Korea to Cebu and Palawan.** According to FFC, "limited open skies" is a strategy of selectively opening specific routes between two countries to unlimited air traffic. A similar policy is in place in Bali, Indonesia, Hawaii and Siem Reap in Cambodia.

3. **Ensure DoT representation in the air panel.** Under EO 32, negotiations leading to the conclusion of ASAs are undertaken by a Philippine Air Panel (PAP) under the chairmanship of the Department of Transportation and Communications and with the DoT as panel member. The presence of the DoT ensures consideration of tourism concerns in the negotiations.

4. **Release restrictions on air access to promote tourism flow.** This is the basis of the advocacy for aviation liberalization, and the major source of disagreement between advocates and opponents of liberalization. While groups such as FFC believe that greater seat capacity would increase demand for tourism, groups like the Save our Skies Movement (an advocacy group established to counter the pro-liberalization efforts), believe that the causality between air access and tourism must first be established before liberalization is pursued.

IV. Progress of Advocacy

The campaign for air liberalization scored the following significant successes, most of which happened during the Arroyo administration:

1. **Reinstatement of the RP-Taiwan ASA on 26 September 2000.** The new RP-Taiwan ASA reinstated the 1996 ASA that the Philippines abrogated in October 1999. Of the total 9,600 seats allotted in the new bilateral agreement, 1,700 seats were given to the Manila-Kaoshiung route and 4,800 to the Manila-Taipei route. The remaining seats were allotted for chartered flights.

2. **Issuance of EO 32 in 20 August 2001.** President Arroyo issued EO 32 to mandate the establishment of the PAP and unify the country's official position in ASA negotiations. EO 32 also replaced airline PAP representatives with consumer representatives, to highlight the policy's bias towards aviation users.

3. **Signing of the RP-Singapore ASA on 25 August 2001 breaks PAL's monopoly in international routes.** The RP-Singapore ASA allowed new Philippines carriers like Cebu Pacific, Air Philippines and Asia Overnight to fly to Singapore, thereby breaking the Philippine Airlines' (PAL) monopoly in international routes. It also permitted Silk Air to uncouple its Singapore-Davao-Cebu service and provide dedicated flights to Davao and Cebu.

4. **Issuance of IRRs for EO 219 and EO 32 on 20 September 2001.** The IRRs for EO 219 and EO 32 operationalized the country's liberalization policy. The salient points are discussed in Appendix 2.

5. **Cebu Pacific's inaugural flight to Hong Kong on 22 November 2001.** Cebu Pacific flew its inaugural flight to Hong Kong, becoming only the second national carrier to service this route. Consumer benefits were immediately felt when Cebu Pacific offered a promotional rate that was $50 lower than what PAL was charging, thereby prompting PAL to lower its price accordingly.

6. **Signing of the RP-South Korea ASA on 29 November 2001.** The ASA gave both countries the option to increase flights from 13 to 17 a week. It also recognized Cebu Pacific as a national carrier allowed to mount flights to Seoul.

7. **Increase of flights to and from UAE on 30 March 2003.** The Philippines and the United Arab Emirates agreed to expand their entitlements by nine frequencies, respectively. This development is significant to the Middle East contract workers who had to contend with the high price and poor quality of service on that route.

Despite impressive progress in the past two years, data provided by Prof. Cherrylyn Rodolfo of the University of Asia and the Pacific show that much more still need to be done. The fact that the capacity of foreign carriers in major routes is almost fully utilized (see Table 7) implies that entitlements for these routes still need to be expanded. Data for 2000 are presented in Appendix 3.

Table 7
Capacity Entitlement and Utilization Rate for Philippine Flights, as of 31 December 2002

Country		Entitlements (based on incoming seats or frequencies per week)	Utilization of Entitlements (%)	
			Foreign	Philippines
USA		36 freq. (Route 2)	69.00	58.00
Japan		45 freq.	100.00	85.00
Hong Kong		15300 seats	80.00	70.00
	Manila	R1=13000 seats	72.00	70.00
	Cebu	R2= 2300 seats	84.00	-
South Korea		17 freq. [a]	100.00	100.00
Germany		7 freq.	100.00	-
United Kingdom		7 freq.	-	-
Netherlands		4 freq.	100.00	-
Singapore		8700 seats [b]	87.00	20.00
Taiwan		6,950 seats		
		Cat I - Taipei and Kaoshiung = 6,500 seats		
		Taipei-Manila (4,800 seats)	95.00	22.00
		Kaoshiung-Manila (1,700 seats)	58.00	-
		Cat II - 450 seats	-	-
Switzerland		3	100.00	-
United Arab Emirates		3	200.00[c]	-
Saudi Arabia		10	80.00	30.00
Kuwait		6	83.00	-

Source: Prof. Rodolfo, UA&P
a-Negotiations were held in November 2001 with South Korea, which resulted to an increase of 4 flights per week (from 13 to 17) for both sides. By May 2002, all of the 17 frequencies were already fully utilized.
b- Entitlements for this route increased from 6,500 seats per week to 8,700 seats per week. No seperate entitlements were given for the Cebu market. However, the increase removed the commercial agreement of Silk Air with PAL for 50 seats (which Silk Air used to borrow under the old agreement).
c-Emirates continued to borrow 3 flights from PAL

Beyond the expansion of entitlements, the implementation of the RP-USA Air Transport Agreement (ATA) of 1980 is the next major hurdle for FFC. The RP-US ATA's implementation was originally scheduled on October 1982, but was deferred five times and for a period of 21 years. The final deferment is on September 2003. FFC is pushing for the implementation of the ATA for the following reasons:

1. **It would benefit 2 million Filipino citizens and Filipino Americans in the United States.** These consumers would benefit from the expected improvements in price and services. They would then be encouraged to travel more frequently to the Philippines, thereby increasing the country's foreign exchange receipts.

2. **It would increase tourism.** The ATA would improve our chance of becoming North America's gateway to South East Asia. This is expected to result in a 20% average annual tourism growth in five years or over US$ 1 Billion in additional revenues. Dr. Limlingan added that aside from the Philippines, only Taiwan and Hong Kong are as strategically located to be the North American gateway. Taiwan is less politically attractive, however, and neither the Philippines nor HongKong has an open skies agreement with the USA.

V. Positive Economic Impact

Ms. Mila Abad, FFC President, said that their advocacy has already resulted in higher visitor arrivals (See Table 9). This in turn, has already benefited the Philippine economy through higher employment and Gross Domestic Product (GDP).

1. **Impact on Consumer Welfare.** The initial successes of the advocacy seem to have improved consumer welfare. Although it is too early to say that liberalization has ushered in a sustainable improvement in prices and services, anecdotal evidence suggests that prices of international travel for the liberalized routes have already fallen and the quality of service has improved, as expected by campaign proponents.

Table 8
Expected Benefits from the Successful Advocacies

Successful Advocacy	Expected Benefits
Taiwan	About 40% of the 3.5million annual traffic from Taiwan to Hong Kong are said to be travelers to China – Hong Kong being a stopover for those who need Chinese Visa. Since Chinese Visa can also be issued in the Philippines, the ASA gave the Philippines a chance to get a slice of this 1.4 million-passenger market.
Singapore	The RP-ASA was expected to provide greater access to about 130,000 Singapore-based Filipinos, 38% of whom were overseas Filipino workers (OFWs). It was also meant to reach around 725,000 Filipinos in Europe who, prior to the signing of the ASA, were not being served by Philippine carriers.
HongKong	There were about 160,000 OFWs in Hong Kong. Cebu Pacific's inaugural flight meant greater access and lower costs for them, as shown by the immediate reduction of airfares between Philippines and Hong Kong.
South Korea	Korea is an important market for the Philippines as it is the country's third highest tourist market is especially significant to the Philippines, as it is the only market that grew last year, by 19.6% or 185,605 visitors during the period January to October.

Source: AGILE Success Stories, FFC

2. **Impact on Visitor Arrivals.** The signing of the above mentioned ASAs seems to have resulted in increased tourism traffic as the growth of visitor arrivals from the Philippines' new partner countries were the highest between 2001 and 2002. Visitor arrivals from Korea grew by 65%, Taiwan by 36%, Singapore by 15% and Hong Kong by 6%. FFC attributed these increases in visitor arrivals to the liberalization of the said routes.

Table 9
Visitor Arrivals to the Philippines, 2001 vs. 2002

Country	Rank in Top 12	Jan-Dec 2002	% Share	Jan-Dec 2001	Growth Rate (%)
China	12	27,803	1.44	14,724	88.83
Korea	3	288,468	14.93	174,966	64.87
Taiwan	5	103,024	5.33	75,722	36.06
Singapore	7	57,662	2.98	50,276	14.69
Hong Kong	4	155,964	8.07	146,858	6.20
Australia	6	70,735	3.66	75,706	(6.57)
Canada	8	54,563	2.82	61,004	(10.56)
U.S.A	1	395,323	20.45	445,043	(11.17)
Japan	2	341,867	17.69	390,517	(12.46)
Germany	10	39,103	2.02	51,131	(23.52)
Malaysia	11	31,735	1.64	42,067	(24.56)
United Kingdom	9	48,478	2.51	74,507	(34.93)
Total (Top12)		**1,614,725**	**83.55**	**1,602,521**	**0.76**
Total (All Markets)		**1,932,677**	**100.00**	**1,992,169**	**(2.99)**

Source: Ms. Cherrylyn Rodolfo, taken from the Department of Tourism
Note: Table 9 ranks these countries based on visitor arrival growth rate

3. **Impact on the Economy.** The liberalization effort may have also contributed significantly to the Philippine economy. According to the World Travel and Tourism Council (WTTC) - an organization composed of travel industry executives - the country's travel and tourism (T&T) sector directly employed an average of 945,000 people from 2000 to 2002, representing about 3.4% of total employment. Including industries serviced by the T&T sector, the employment figure grows to 2.87 million or 10.3% of total employment (See Table 10).

Table 10
T&T as % of National Accounts

	[illegible]	[illegible]	2000	2001	[illegible]	[illegible]	2013P
Personal T&T	7.40	5.92	5.77	5.31	5.42	5.52	6.73
Government Expenditures	3.54	3.54	3.54	3.52	3.53	3.53	3.64
Capital Investment	12.20	2.22	2.32	2.20	2.17	2.18	2.55
Exports	8.24	8.52	7.69	7.76	6.89	6.32	5.75
T&T Imports	7.66	6.62	6.45	5.89	5.77	5.54	5.47
T&T Industry Aggregates (Direct Impact)							
Employment ('000)	4.01	3.74	3.61	3.42	3.18	3.08	3.06
Gross Domestic Product	3.55	3.40	3.27	3.06	2.79	2.69	2.87
T&T Industry Aggregates (Direct and Indirect Impact)							
Employment ('000)	11.35	11.01	10.88	10.31	9.84	9.66	9.60
Gross Domestic Product	9.31	8.68	8.62	8.01	7.51	7.39	8.17

Source: WTTC 2003 Report

VI. Conclusion and Recommendation

The liberalization of the Philippine international aviation industry has progressed significantly since 2000, thanks to the effort of advocacy groups such as FFC. This progress has resulted in consumer benefits, tourism growth and increased employment and economic output. Moving forward, it may be worthy for liberalization advocates to consider pursuing the following recommendations in addressing the concerns of those who oppose liberalization and in further strengthening the liberalization policy's legal foundation.

1. **Commission a study to show the net macroeconomic benefit of liberalizing international routes.** Economic theory supports the view that the liberalization of the airline industry would be beneficial to a local economy. The liberalization of the Philippine international aviation market is however, being opposed by certain sectors because of fears that the benefits of liberalization could outweigh its costs. Although studies conducted in United Kingdom and Australia, among others, empirically support their claims, advocates for the liberalization of international routes in the Philippines may want to consider commissioning a cost and benefit study that would also address the following:

    - **The effects of partial exportation of consumer surplus.** Liberalizing the industry is meant to improve consumer welfare, but being global in scope, airline consumers comprise both foreign and local clients. The study could therefore isolate the consumer benefits accruing to local clients in order to determine the advocacy's impact on the local economy.

    - **The effects on T&T National Accounts.** The study could also measure the expected dynamic effects of liberalization and build on the T&T Accounts shown in Table 10 as recommended by the World Trade Organization in its meeting last June 16, 2003 (Appendix 4).

    - **Determine the economic leakage in tourism.** Leakage comes in the form of repatriated funds to foreign-owned tour operators, airlines, hotels, imported drinks and food, etc. The United Nations Environment Program cited a study, which estimated that "70% of all money spent by tourists in Thailand ended up leaving the country. Estimates for other Third World countries range from 80% in the Caribbean to 40% in India." This leakage could depress the benefits of liberalization in the Philippines.

    - **Determine the elasticity of demand.** The success of aviation liberalization rests on the assumption that greater air seat capacity would reduce airfares and improve tourism. The study could therefore show that: 1) liberalization could increase supply, 2) greater supply could reduce prices and 3) demand is price elastic. Dr. Tristan Macapanpan of the De la Salle University Graduate School of Business, for example, argues that while a greater number of flights could cater to a greater number of tourists, raising air seat capacity alone would not cause tourism to grow. He claims that historical data show that tourism also depends on economic development and peace and order situation, among other things.

    - **Determine the impact on PAL and the industry itself.** Some FFC members believe that the liberalization of the airline industry would eventually result in PAL's bankruptcy. While this may be healthy for the industry in the long run, the proponents may consider studying its impact on the economy in terms of unemployment, financial market distortion (PAL owes over $2 billion dollars to the financial market) and trade disruption. A briefing paper issued by the Federation Institute for Business and Economic Research, warns that the liberalization of the airline industry at this time could result in the displacement of almost 1.1 million employees in the tourism industry.

The study may also include a discussion on the liberalization's expected impact on the industry. Prof. Rigas Doganis, a noted expert on the aviation industry, says that the economic benefits expected from liberalization may not actually come because the structure and parameters inherent in the airline industry is unlike those found in others. Steep barriers to entry prevent firms from freely joining the industry while high sunk costs such as advertising prevent them from freely getting out.

2. **Amend RA 776.** While advocates such as FFC believe that EOs 219 and 32 are sufficient to liberalize the airline industry, they may want to consider pursuing an amendment to RA 776 and its IRRs to make the liberalization policy more sustainable. We may note that it is the absence of a law that categorically declared such policy that allowed various Philippine presidents like Marcos and Estrada to implement more conservative policies in the past. While EOs 219 and EO 32 may be sufficient in promoting aviation liberalization in the near term, they may not stand revocation should a new administration prefer a protectionist stance. The amendments may include clear declarations on the following:

   - **Definition of public interest.** EO 219, EO 32 and their IRRs clearly intended to prioritize the interest of airline consumers over that of airline companies when they liberalized the airline industry. The amendment could categorically declare this as a statement of policy to put to rest any contradictory arguments that only delay liberalization.

   - **Provisions on safety nets.** The liberalization of the airline industry would result in losers as well as winners. The amendment to RA 776 may want to include provisions that outline safety net provisions that would ease the negative impact on labor, trade and the economy in general, if and when PAL closes down.

Appendix 1: Herfindahl-Hirschman Index

The increase in competition in the air transport industry can also be seen in the industry's concentration level. From a monopolist situation in 1994, the industry's Herfindahl-Hirschman Index (HHI) significantly fell to 0.35 in 1999. The HHI is a measure of market concentration where an index of one denotes a monopoly while an index closer to zero shows a more competitive market. The inverse of the HHI denotes the degree of effective competition. The data shows therefore that by 1999, the industry is behaving as though there were almost three market players involved.

Year	1/HHI	HHI
1994	1.0000	1.0000
1995	1.0897	0.9177
1996	1.5530	0.6439
1997	2.0500	0.4878
1998	2.6192	0.3818
1999	2.8769	0.3476
2000	2.5478	0.3925
2001	2.6589	0.3761
2002	2.8303	0.3533

Source: "The State of Competition and Market Structure of the Philippine Air Transport Industry". PIDS

Appendix 2: Salient points in the IRRs for EO 219 and EO 32

1. **They emphasize the government's withdrawal of the country's one airline policy.** The IRRs mandate the designation of at least two international carriers to promote competition in the international market. It allows the designation of additional carriers in the event that the others fail to service the country's total frequency entitlements as prescribed in Air Services Agreements (ASAs).

2. **They mandate the awarding of traffic rights based on a broader definition of national interest.** The IRRs mandate the CAB to consider the country's larger interest in negotiating for the exchange of traffic rights and routes with other countries. The definition of national interest is broadened to include the interests of the users of air services such as those involved in international trade, foreign investments and tourism, among others.

3. **They maintain the liberalization of domestic routes.** The IRRs provide for the liberalization of domestic air transportation through the automatic approval of rates, charges and fares on routes operated by two or more air carriers.

4. **They specify time limits within which designated carriers must utilize their entitlements.** The IRRs require official international carriers to operate their allocated entitlements within six months from the date of allocation. The IRRs mandate the CAB to reallocate unutilized entitlements to another official international carrier.

5. **They recognize the need for separate treatment of passenger and cargo services in ASAs.** The IRRs mandate the CAB to give pure cargo and passenger services their respective provisions for designation of air carriers, capacity and frequency entitlements. This recognition highlights the fact that the operation of freighters is a different business from passenger airlines.

6. **They streamline the negotiation process for ASAs.** The IRRs unify the air negotiating and consultation panels into one Philippine Air Panel (PAP), headed by the Department of Transportation and Communications, thereby hastening the ASA negotiation process. The presence of the Department of Tourism in the PAP safeguard tourism, trade, and investments concerns, while the relegation of airlines to observer status minimizes their influence over PAP activities.

Appendix 3: Capacity Entitlement and Utilization Rate for Philippine Flights, as of 31 December 2000

Country	Entitlements (based on incoming seats or frequencies per week)	Utilization of Entitlements (%)	
		Foreign	Philippines
USA	36 freq. (Route 2)	69.00	69.00
Japan	43 freq.	100.00	59.00
Hong Kong	15300 seats	85.10	-
Manila	R1=13000 seats	86.50	65.00
Cebu	R2= 2300 seats	73.90	-
South Korea	13 freq.	100.00	100.00
Germany	7 freq.	100.00	-
United Kingdom	7 freq.	57.00	-
Netherlands	4 freq.	100.00	-
Singapore	6545 seats	100.57	39.00
	R1= 5,600 seats	99.70	-
	R2=945 seats	105.01a	
Taiwan	6,950 seats	88.50	-
	Cat I - Taipei and Kaoshiung = 6,500 seats	-	-
	Taipei-Manila (4,800 seats)	96.83	-
	Kaoshiung-Manila (1,700 seats)	65.05	-
	Cat II - 450 seats	-	-
Switzerland	3	100.00	-
United Arab Emirates	3	200b	0%
Saudi Arabia	10	100.00	60.00
Kuwait	6	83.30	-

Source: Prof. Rodolfo, UA&P

a-Silk Air has entered into a commercial agreement with PAL for 50 seats

b-Emirates Air has entered into a code sharing agreement with PAL for 3 extra flights

Appendix 4: New Article on Tourism Satellite Account

Manila Bulletin, June 19, 2003
By Rachel Castro-Barawid

The World Tourism Organization (WTO) yesterday underscored the need for a country to come up with an effective tool to measure the economic impacts of tourism during the second day of a technical workshop participated in by over 25 nations at the Makati Shangri-La Hotel.

The timely proposal of WTO, the Madrid-based leading international organization in travel and tourism, was made during the Tourism Satellite Account Workshop (June 16-17) that kicked off the five-day series of events in Manila organized by the WTO and the Department of Tourism (DoT).

Antonio Massieu, WTO chief for Statistics and Economic Measurement of Tourism urged tourism ministers, industry leaders and practitioners of countries in the Asian Region, including the Philippines to develop a Tourism Satellite Account (TSA) that will help determine the importance and benefits of tourism to the economy; and ultimately help achieve international comparability and credibility.

Massieu pointed out that nations must recognize the valuable contributions of tourism "in the generation of GDP (primary income of a country); net foreign earnings; of tax earnings; of employment; of output and demand in a variety of activities and products; in maintaining a balance between regions and stopping the migration of population to major cities; and in its participation in the preservation and enhancement of natural resources and historical heritage."

"The TSA is not a bible, it is just to be taken as guidelines that will serve as a useful instrument in measuring tourism statistics," he clarified.

According to him, the TSA is a macroeconomic framework that has a philosophical approach, theoretical context and empirical instruments to measure and verify main trends of an activity. It provides a complex statistical instrument indispensable to measure the economic impact of tourism. The system also includes a set of tools to make a proper description and analysis of tourism.

In the development of the TSA, Massieu said it is important to involve national statistics offices, the unit involved in compiling national accounts. The governments or in some nations, national tourism administrations must also keep a close collaboration between the private sector who are the main providers and users of information and the potential users of information on tourism such as universities, research institutions, etc.

As a preliminary step in the development of a TSA, the WTO expert proposed that each country adopt a set of indicators which are of macroeconomic nature and on tourism activity. The creation of this, Massieu noted, will make it possible to perform an analysis of the economic impacts of tourism on a country's overall economic activity, before taking on the full development of the TSA.

Through this, Massieu said it will be possible to see tourism's place in the context of the national economies in terms of its relative weight in the economy, whether or not the country has decided to carry out the TSA.

Appendix 4: New Article on Tourism Satellite Account

After learning the step-by-step process in developing the macroeconomic indicators and eventually the TSA, the delegates were given concrete examples on how other countries are coming up with their own. The Philippines' status on the development of a TSA was reported by Dr. Romulo A. Virola, secretary general of the National Statistics Coordination Board. Further in-depth case studies on the creation of a TSA for Malaysia, Thailand, India, Indonesia, and Australia were also presented by respective country representatives, Malaysian deputy sec. gen. Shahril Bin Saat of the Ministry of Culture, Arts and Tourism; Tourism Authority of Thailand director of Planning Dept. Auggaphon Brickshawana; J.N. Dash, joint director general for Market Research of the Ministry of Culture and Tourism of India; Adi Lumaksono, chief of Tourism Statistics Division of the BPS Statistics Indonesia and Rusman Heriawan of the Statistics Bureau; and Stan Fleetwood, research manager of the Tourism Division, Department of Industry, Tourism and Resources of Australia. Through this, Massieu said it will be possible to see tourism's place in the context of the national economies in terms of its relative weight in the economy, whether or not the country has decided to carry out the TSA.

Appendix 5: Freedoms of the Air

First freedom – the right of an airline of one country to fly over the territory of another country without landing.

Second freedom – the right of an airline of one country to land in another country for purposes of refueling and maintenance while en route to another country, but not to pick up or disembark traffic (passenger, cargo or mail).

Third freedom – the right of an airline of one country to carry traffic from its country of registration to another country.

Fourth freedom – the right of an airline of one country to carry traffic from another country to its own country of registration.

Fifth freedom – the right of an airline of one country to carry traffic between two countries outside of its own country of registration as long as the flight originates or terminates in its own country of registration.

Sixth freedom – the right of an airline of one country to carry traffic between two foreign countries via its own country of registration (i.e., combination of third and fourth freedoms).

Seventh freedom – the right of an airline of one country to operate flights between two other countries without the flight originating or terminating in its own country of registration.

Eighth freedom – the right of an airline of one country to carry traffic between two points within the territory of another country (or cabotage rights).

Note: Sixth to eighth freedoms are supplementary freedoms although not officially recognized by the International Civil Aviation Organization (ICAO).
Source: World Trade Organization (1996)