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INVESTMENT CLIMATE BRIEFS

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Preface

This report is the result of technical assistance provided by the Economic Modernization through Efficient Reforms and Governance Enhancement (EMERGE) Activity, under contract with the CARANA Corporation, Nathan Associates Inc. and The Peoples Group (TRG) to the United States Agency for International Development, Manila, Philippines (USAID/Philippines) (Contract No. AFP-I-00-00-03-00020 Delivery Order 800). The EMERGE Activity is intended to contribute towards the Government of the Republic of the Philippines (GRP) Medium Term Philippine Development Plan (MTPDP) and USAID/Philippines' Strategic Objective 2, "Investment Climate Less Constrained by Corruption and Poor Governance." The purpose of the activity is to provide technical assistance to support economic policy reforms that will cause sustainable economic growth and enhance the competitiveness of the Philippine economy by augmenting the efforts of Philippine pro-reform partners and stakeholders.

The American Chamber of Commerce in the Philippines (AmCham) submitted an unsolicited proposal to EMERGE on January 25, 2006, for a grant to set up a mechanism to identify and communicate to the Philippine Government activities that will generate additional investments and jobs in the country. It was called the Investment Climate Improvement Project (ICIP), and the key actors were Mr. Robert M. Sears, AmCham Executive Director, Mr. John D. Forbes, AmCham Legislative Committee Chairman, and Mr. Robert W. Blume, AmCham Desk Officer at the Philippine Board of Investments (BOI). Mr. Richard Umali was added to the team as a Project Assistant. EMERGE subsequently hired Mr. Arlan Z. I. Brucal to help AmCham draft this and other summary reports.

The views expressed and opinions contained in this publication are those of the author and are not necessarily those of USAID, the GRP, AmCham, EMERGE or the latter's parent organizations.

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Executive Summary

As part of the USAID-funded Investment Climate Improvement Project (ICIP), the American Chamber of Commerce Philippines (AmCham) undertook research and analysis on key factors that affect investment, both local and foreign direct investment. These Investment Climate Briefs contain the results of the research and analysis on specific investment-related problems. The briefs reflect research on specific topics relevant to investment. Among the relevant investment concerns that it has surfaced are: (1) the legislated wage increase and its impact on labor competitiveness and investments; (2) the need for consistent and predictable regulation and policies in the mining sector; (3) policy reversals in liberalizing aviation at the Clark and Subic International Airports; and (4) the progress as well as the challenges of the strategic transport infrastructure along the Subic-Batangas Corridor. These briefs are designed as documents useful for advocating reforms to improve the investment climate.

Unveiling the legislated wage hike. On the surface, Rep. Crispin Beltran's House Bill No. 345 legislating a P125 across-the-board nationwide wage increase for workers in the private sector and HB 1064 mandating a P3,000 across-the-board salary increase for government workers may appear good for Filipino workers. Nevertheless, further and deeper investigation would elicit the adverse effects of these laws, such as the sudden rise in inflation and massive unemployment. Given the already high labor cost in the country and the increasing concerns increase in wages amongst major investors, the proposed legislated wage increase would negate and even outweigh their foreseen benefits in the economy. As such, rather than giving wage determination responsibility to the central government, it is recommended that the existing mechanism for considering changes in the minimum wage by Regional Tripartite Wage and Productivity Boards be maintained, as they are the ones who can take into account the needs and concerns of business, government and labor as well as variations in local conditions in the country, more than anyone else.

Unrealized potential sector: Mining. The Philippine economy has experienced notable growth in recent years owing mainly to a strong Services Sector. While generally laudable, the scenario nevertheless illustrates the unrealized potentials of and untapped opportunities in other industries, particularly in mining. The Mining Industry can generate foreign direct investment of up to US$5 billion annually, provided that the country's mining regulations, particularly the Mining Act, are implemented fairly and consistently. The challenge is not in rewriting these laws, but in their enforcement. Together with the government's revitalization efforts to provide sufficient infrastructure support and reduce administrative bottlenecks, the proper enforcement of Philippine mining rules will enable the Philippine Mining industry to take a sizeable share of an increasingly competitive and international mining market and live up to its full potential.

The fuss over "open skies". Executive Order (EO) 500 which declared open skies in Clark, Pampanga could have been an effective tool in stimulating more robust growth in the country. However, even before it was implemented, EO 500 was reversed with the signing of EO 500-A on August 22, 2006. This action is feared to weigh down the increasing tourism industry in the country by halting the entry of new foreign airline carriers in Clark, which consequently diminishes tourism arrivals, thereby hindering the spur of investments in the free zone and in the rest of the country as well.

Realizing the need to make the country more friendly to investors, it is suggested that the government must be true and consistent with its agenda of liberalizing the airline industry at least for Clark and Subic. They can do this by rescinding EO 500-A, or amending it with EO 500-B. EO 500-B is seen to help Clark achieve its goal of becoming a premier international hub in the short term, and to enable the country to realize and exploit the tremendous potential of the rising tourism sector.

The controversial NAIA IPT-3. The public has yet to see the opening of the Ninoy Aquino International Airport International Passenger Terminal 3 (NAIA IPT-3), despite the accomplishment of construction in 2002, due to fraud, bribery and corruption controversies hounding the contract. The controversy peaked when President Gloria Macapagal-Arroyo decided not to honor the contract with Philippine International Airport Terminals Co., Inc. (Piatco) due to overpricing and flawed bidding, which was followed by the Supreme Court's declaration a year after that the airport contract was null and void. To date, the government is still trying its best to contest Piatco's claims for a total of $565-million compensation by the Philippine Government before the International Chamber of Commerce-International Court of Arbitration (ICC).

Notwithstanding the NAIA IPT-3 mess, the government is optimistic that it will meet its 2007 target for opening the airport. In addition, deferring the opening of the new airport would serve as a major setback in developing the Subic-Clark-Batangas (SCB) Corridor, which laid out hard infrastructure projects, particularly improving the transport system. The conflict has already resulted in unrealized investment potential and has taken its toll on economic growth and development.

Unveiling the Legislated Wage Hike

"A major and critical ingredient for the economic success of the Northeast Asian and three ASEAN countries is the fact that wages in these countries have been determined largely through the workings of the demand for and supply of labor services This ensures a strong linkage between productivity changes and wage adjustments.."

– Ponciano S. Intal, Jr. from World Bank 1993, Chapter 6

"It appears that Congress overlooks the reality that the Philippine economy does not operate independently of other economies. It is hard to understand why they favor a law that will benefit the country's competitors and cause hard-working Filipino voters to lose their jobs."

– The American Chamber of Commerce of the Philippines, Inc.

On the surface, Rep. Crispin Beltran's House Bill (HB) No. 345 legislating a P125 across-the-board nationwide wage increase for workers in the private sector and HB 1064 mandating a P3,000 across-the-board salary increase for government workers may appear good for Filipino workers. For one, workers claim that wages have remained low through the years mainly because the "Regional Tripartite Wages and Productivity Boards (RTWPBs)[1] have not granted wage hikes that are substantial enough to provide relief to workers."[2]

Analyzing the wage increases granted by the RTWPBs from 1999 to 2006, the NCR-based workers were provided the highest cumulative wage increase of P126.50 ($2.58), of which P50 ($1.02) was in the emergency cost of living allowance (ECOLA) and not in the basic pay. In the case of workers in other regions, the RTWPB-granted cumulative wage increase ranged from P30 or $0.61 (Mimaropa) to P102.50 or $2.09 (Central Luzon).

Workers also argued that the cost of living has been rapidly accelerating for the past decade, which then dramatically weakens their purchasing power and keeps the Filipino toiling class in their long-term poverty.

While passing these bills into law appeal to be noble for the working class, further and deeper analysis would suggest the otherwise. Indeed, the adverse effects of these laws, such as a rise in inflation and unemployment, would negate and outweigh their foreseen benefits in the economy.

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[1] The RTWPBs are tasked to determine the most appropriate minimum wage levels in their respective areas of jurisdiction, taking into account regional/area-specific socio-economic differences and industry peculiarities, under Republic Act No. 6727, also known as the "Wage Rationalization Act" of 1989.

[2] Arao, D. [2007] "The Logic Behind a Legislated Wage Hike" found at http://www.bulatlat.com/news/6-49/6-49-wage.htm.

Learning from the past

Until the late 1980s, the Philippine experience departs heavily from those of the progressive East Asian countries (Intal, 1997). In fact, there had been a negative relationship between changes in real wages and labor productivity in the Philippines (Table 1). What may account for this negative relationship is the political economy of wage determination and labor relations in the Philippines.

Table 1. Indices of Labor Productivity and Real Wages (1980=100)

	Labor Productivity		*Real Wages*	
	Agriculture	*Manufacturing*	*Farm Workers*	*Unskilled Laborers Manila*
1970	97	57	109	214
1980	100	100	100	100
1990	93	90	143	170
1993	88	80	150	174

Note: Real wages for farm workers is based on daily wages (in cash and kind) of farm workers without meals in major crops deflated by the CPI for outside national capital region.

Source: Khan 1995, pp. 3, 7

Specifically, in the latter part of 1980s, while the rise in real wages among East Asian countries was attributed to increases in labor productivity, the Philippines' real wages in the formal sector rose due to the increased political power of the labor unions. Labor productivity was nonetheless sluggish, as a result of low capital accumulation brought by slow industrial development. As a result, labor cost increased substantially in contrast to its Asian neighbors. The rising labor cost, together with a troubled industrial environment and political uncertainty, made the Philippines the least favored investment site in Southeast Asia during the late 1980s and early 1990s.

Unit labor cost[3] in the Philippines is also highest compared with Malaysia and Thailand in the 1990s (Table 2). Specifically in 1999, the Philippines had a unit cost reaching 1.24, compared to Malaysia's 0.88 and Thailand's 079 in the same period. This

[3] Unit labor costs computes for the nominal wage per unit output of labor rather than measuring the nominal wage per worker. In essence, a P300 daily wage to worker producing 10 units of output per day costs less than a worker paid the same amount and produces only 5 units of output per day. Thus, a country with lower unit labor cost is said to more competitive than a country with a higher unit labor cost.

clearly denotes the relative decline in the country's labor competitiveness, which plays a significant role in attracting foreign investment.

Table 2. Comparative Unit Cost of Labor (1992=1.00)

	Philippines	Malaysia	Thailand
1987	0.84	1.02	-
1988	0.86	0.93	-
1989	0.90	0.88	0.92
1990	0.93	0.86	0.93
1991	0.97	0.88	0.96
1992	1.00	1.00	1.00
1993	1.01	1.02	0.95
1994	1.04	1.03	0.90
1995	1.02	1.11	1.00
1996	1.20	1.16	1.01
1997	1.19	1.10	0.87
1998	1.22	0.83	0.66
1999	1.24	0.88	0.79

Source: Jurado (2000)

The Current Status

The recent "comparative survey of the labor environment in ASEAN, China and India[4]" conducted by the Japan External Trade Organization (JETRO) revealed that unemployment rate in the Philippines is the highest in the region, reaching to a double digit 12 percent in 2004, much higher compared to 9.9 and 3.5 of Indonesia and Malaysia, respectively.

Comparing wages in the region on a monthly basis, a comparative survey of the labor environment in ASEAN, China and India shows that the Philippines has a relatively higher minimum wage compared to its Asian neighbors. Specifically in 2006, the Philippines' minimum wage reached $135, significantly higher than $90 and $110 of Indonesia and Thailand, respectively. It is even higher than Vietnam's $50 and China's $92 (average of Guangzhou , $98, and Dongguan, $86).

Although there is a positive trend in the region, average nominal wage growth rate is seen to be high in the Philippines, reaching 9.9 percent in 2005. Thailand and Malaysia only had 5.9 and 5.7 percent, respectively, during the same year.

[4] Japan External Trade Organization [2006] "comparative survey of the labor environment in ASEAN, China and India" found at www.jetro.go.jp/thailand/e/data/laborsurvey06.pdf

Also, in the questionnaire survey distributed by JETRO to Japanese companies, the "rising wages for employees" received the highest response rate among the issues listed under employment and labor aspects. In particular, 60.2 percent stated that wages are regarded as the main problem in labor and employment.

On Legislated Wage Hike and Overall Welfare

Given the country's relatively more expensive labor vis-à-vis countries like Indonesia, Thailand, Malaysia, China and Vietnam and as the Philippine economy relies heavily on labor intensive manufactures and tradable services (e.g., tourism, business process outsourcing), it is apparent that the discordant relationship between labor productivity growth and real wage adjustments of the past decade has to change.

There are so many approaches on how resolve this dilemma, and ultimately improve the country's labor competitiveness, but none of them includes the increase in legislated wages. On one hand, legislating wage increases in the Philippines poses a major threat to the country's competitiveness position. On the other hand, it will be disastrous for labor and employment if a legislated wage increase, such as the HB 345 and HB 1064, becomes law.

One adverse effect of such a legislated wage increase is a rise in inflation. Indeed, the National Economic and Development Authority (NEDA) Director General Romulo Neri said that a wage hike will result in a two-percentage point increase in the country's inflation rate. While the legislated wage increase will benefit some 12.46 million of the 35.8 million labor force, Presidential Management Staff Secretary Remonde stated that "the own-account workers and unpaid family workers numbering 16.3 million, the 1.6 million in private households, and even the 2.5 million in government and government-owned corporations who will not benefit from this windfall will bear the additional cost of inflation."

The wage setting measure will also result in loss of employment as small establishments not able to bear the cost of wage increase will be forced to shut down. Based on a 2004 survey of establishments, 91 percent or 713,566 were micro enterprises, with employees of nine or less, with only 0.8 percent (even less than 1 percent) or about 5,856 establishments in the medium and large scale, employing 100 – 199 and 200 and over, respectively. Small enterprises, with employment of 10 to 99, account for 8.2 percent or 64,500 establishments. By employment, there were 2.07 million in the micro, 1.42 million in small enterprises, 0.403 million in medium, and 1.73 million in large enterprises. Not to mention that the Philippines already has very high unemployment, the wage increase will exacerbate the already deteriorating condition in the labor market.

"If it isn't broken, don't fix it."

The current wage setting mechanism is done through the 17 RTWPBs, pursuant to Republic Act No. 6727, also known as the "Wage Rationalization Act" of 1989.

Accordingly, the boards issued wage orders granting wage increases ranging from R3 to R27 per day in June-August 2006. In fact, since 1990, a total of 187 wage orders have been issued, 58 percent of them were *motu proprio* or on the board's initiative.

This clearly shows that the RTWPBs are doing their job, contrary to claims that the boards have forgotten the welfare of the laboring class. Therefore, the existing mechanism for considering changes in the minimum wage by Regional Tripartite Wage and Productivity Boards should be maintained as they are the ones who can take into account the needs and concerns of business, government and labor, as well as variations in local conditions in the country, better than anyone else.

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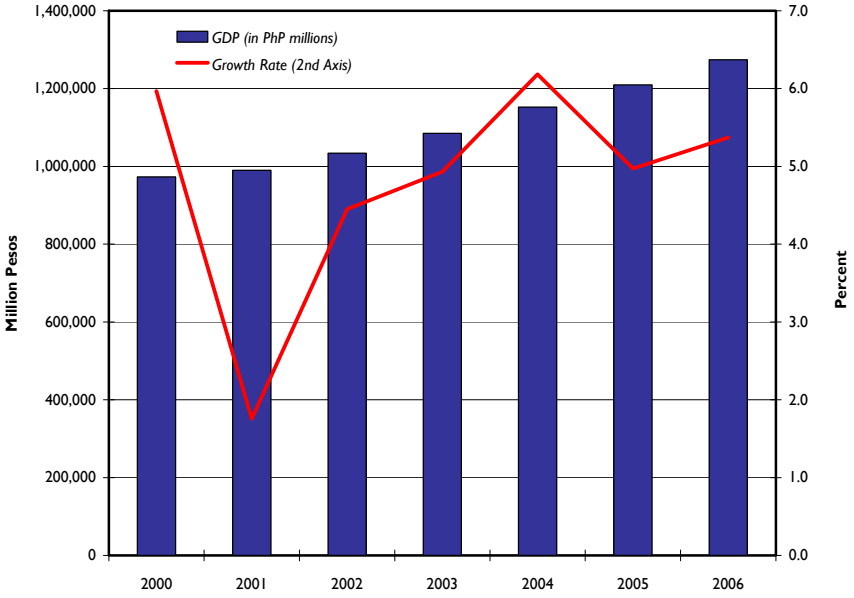
Unrealized Potential Sector: Mining

The Philippine economy has experienced moderate growth in recent years. From only PhP0.97 trillion in 2000, the country's GDP has grown at an average rate of 4.60 percent[5] to reach PhP1.27 trillion by the end of 2006. In fact, the country's economy has sustained growth of at least 5 percent over the past three years, significantly better than the 2.8-percent average between 1996 and 2000. The Services Sector has emerged as the main driver of growth, accounting for nearly half of total output and growing at an average rate of 6.3 percent in the past six years.[6]

Figure 1. Philippine GDP and GDP Growth, 2000 – 2006
(In constant 1985 prices)



Source: NSCB

While generally seen as positive, the scenario leaves room for improvement, especially for other sectors whose contributions to growth, investment and employment have yet to be developed. Mining is among those industries that have been identified as having unrealized potential and untapped opportunities.

The poor performance of the mining industry is indicative of its untapped potentials, considering that the Philippines is one of the most highly mineralized countries in the world. The country boasts of nine million hectares of potential mining

[5] Compound average growth rate (CAGR). GDP expressed in 1985 constant prices.
[6] Institute for Development and Econometric Analysis (IDEA), Inc. *Economic Outlook*, February 2007.

land; however, only about 1.4 million hectares are utilized or covered by mining permits. In 2002, the Mines and Geosciences Bureau of the Department of Environment and Natural Resources (DENR) estimated the country's gold reserves at about 967 million metric tons, while copper was at about 5,302 million metric tons. In this regard, the Philippine Mineral Exploration Association has identified 12 high-potential mineral areas throughout the country, including three sites in Benguet, Surigao del Norte and Southern Cotabato that have significant deposits of gold and copper. Areas in the northern Sierra Madre region, Southern Tagalog region, Southern Palawan and Eastern Mindanao are also being prioritized for their nickel deposits, while Zambales, Leyte and Samar provinces are potential sources of platinum, cobalt and chromium.

Problems with an Uncertain Regulatory Environment

To a large extent, an uncertain regulatory environment has often been cited as the primary reason for why the mining industry has not reached its full potential. The problem was arguably at its worst in January 2004, when the Supreme Court declared as unconstitutional certain provisions of the Philippine Mining Act of 1995, particularly the provisions that allowed foreign-owned entities to engage in large-scale mining operations in the country. The Supreme Court also ruled as illegal the Financial or Technical Assistance Agreement (FTAA) signed by the Government with Western Mining Corp. Philippines. However, in December of the same year, the Supreme Court reversed its earlier decision and ruled as constitutional the provisions that allowed foreign investors to explore, develop, and utilize the Philippines' mineral resources. While the move was generally lauded, it nonetheless illustrated the arbitrary application of mining laws and regulations in the country, a problem that deterred investors, both domestic and foreign.

Thus, without consistent and definitive rules to govern mining activities and investments, investors found opportunities elsewhere, while special-interest groups, including environment advocacy organizations and particularly the influential Roman Catholic Church, opposed mining projects. The problem was also exacerbated by an underdeveloped infrastructure network and complicated administrative procedures. Consequently, the mining industry failed to grow and live to its potential, contributing an average of only about 1.4% to the country's GDP from 2000 to 2006. Mining exports also declined.

The Supreme Court's declaration on the legality of the participation of foreign firms in the mining sector is expected to aid in the government's efforts to revitalize the industry through foreign direct investment. In 2005, US$140 million out of the US$1.8 billion in foreign investment registered with the BOI was in mining and is expected to spur further inflows and job creation. The Wallace Business Forum (WBF) expects the mining industry to capture annual FDI of about US$500 million to US$5 billion from 2007 to 2010. The WBF sees 10,000 new jobs for every US$100 million worth of investments. These estimates are, of course, hinged on key assumptions or requirements for them to be met, including the government's unwavering implementation of its Mining Revitalization Program, a sustained world demand for metals, and minimal opposition to mining projects from various lobby groups.

However, accidents, such as a spill at a foreign mine on Rapu Rapu Island, Albay, in late 2005, have the potential of halting the revitalization of mining and reverse some of its initial benefits. As a result of the spills, the Department of Natural Resources (DENR) ordered the involved mining company to temporarily cease operations and to set up safeguards to comply with the DENR's standards on sustainable mining. The mining company promptly and adequately responded to the challenge and conducted a four-month test run in late 2006 that was made open to the public and subjected to third-party evaluation. Despite the recommendations by the Rapu Rapu Fact Finding Commission headed by Bishop Arturo Bastes of Sorsogon that called for the closure of the mine and a review of the country's mining law, the DENR allowed the mining company to resume operation in February 2007 after the test runs were transparently and strictly monitored.

In essence, then, the government must be fair, consistent, and definitive in applying the rules that govern mining activities and investments in the country. The Joint Foreign Chambers (JFC) believes that the government was correct in allowing the mining company to resume operations, because the government and the company concerned acted responsibly in addressing the spills. More important, it sends a positive signal to the international mining industry and to potential investors who will otherwise lose interest in the country. In this regard, the mining guidelines of the DENR must be strictly implemented.

Other Issues and Challenges

Furthermore, despite the encouraging developments in the mining industry, there have also been several other setbacks. Despite the government's efforts to simplify procedures for mining applications (through DENR AO 2004-54 and various Memorandum Orders), industry players still complain about the long time it takes for mining permits to be approved. Moreover, according to the Mines and Geosciences Bureau, foreign investment in mines actually plunged by 76% to $109 million in 2006, although this is also partly due to project delays caused by buyouts and transfers of ownership.

In this regard, the WBF identifies some necessary courses of action in five key areas if the mining industry were to reach its potentials and optimize its growth[7]:

(1) On the *legislative* side, the WBF sees the proper implementation of the Mining Act as the key to helping the industry along its growth path. No further amendments or revisions to the Act are necessary at the moment, as these are seen to only make the regulatory and investment environment more ambiguous.

In addition, the JFC believes Philippine mining laws are comparable to those of more developed countries such as Australia, Canada, and the US. The issue really

[7] Peter Wallace, Report on Breakout Session on Mining, Workshop on Foreign Direct Investment, October 5, 2006.

is with the enforcement of these laws, which, if done properly, is seen to ensure that mining is done responsibly and with the least environmental damage.

(2) In this sense, the government, from an *administrative* point-of-view, must also ensure that it implements its regulations consistently, as arbitrary rules tend to scare off foreign investors. The government must also simplify and speed up its permitting systems, as bureaucratic red tape imposes significant opportunity costs.

In this regard, it would help if the government were to rationalize different mining-related activities into separate organizations; for instance, the DENR retains control over environmental concerns, while its promotion and development efforts will be transferred instead to the Department of Trade and Industry or the Board of Investments. In the long term, however, the government must establish a department that is strictly devoted to all mining-related endeavors.

(3) The government must also provide *infrastructure support* to mining activities throughout the country. Aside from interconnected road networks that lead to and from different mines, seaports as well as airports near mine sites are also needed to facilitate transport. Sufficient electricity must also be provided to mine sites.

(4) On the *financial* side, a mechanism to protect and attract stock market investors must also be established. In this regard, the government should support the initiative by the Philippine Stock Exchange (PSE) to come up with internationally aligned disclosure standards for mining. Mechanisms to raise venture capital through the PSE must also be designed and implemented.

(5) Finally, *human resources* must be developed for the industry to remain viable, especially in the long run. Strong linkages with the academe must be forged to aid in manpower training and development. In addition, information and education campaigns regarding various mining programs and operations must sufficiently clarify misconceptions on the industry to help elicit the support of local government executives as well as the Church and other organizations.

Conclusion

Mining industry appears poised for its long-anticipated takeoff. With the government's revitalization efforts and investors' renewed confidence, the industry can expect more investments to come in from Australia, Canada, South Africa, the US, and other countries. The government projects about $6.7 billion in FDI from its 24 priority projects between 2004 and 2010. Finally, prices of metal are expected to increase in the next three to five years as world demand remains high. In particular, demand from India and China, particularly for copper and nickel, bodes well for mining in the Philippines. China's demand for copper is driven by the rapid growth of its construction, cable production and electrical equipment industries. India's demand, on the other hand, is driven by the strong performance of its auto and construction industries.

The benefits to the country of a competitive and sustainable mining industry cannot be over-emphasized. Mining can be a major contributor to economic growth by providing employment, especially in rural communities. In addition, mining can bring in significant revenues to the government.

In this regard, the government's revitalization efforts seem to be centered on infrastructure projects and various programs to ease administrative bottlenecks that are all aimed at making the country a worthwhile destination of much-needed foreign investment. Nevertheless, the administrative and infrastructural support must first and foremost be complemented with a fair and consistent enforcement of the country's mining laws in order for the industry to realize its potential.

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The Fuss over "Open Skies"

The domestic economy is experiencing growth in the tourism industry with good prospects for the sunrise health care and wellness sub-sector, as well as foreigners' retirement. More visitors are discovering the Philippines as a place to relax and unwind, and also a place that can provide world-class health care at a fraction of the price offered in developed countries. Aside from health care, the government is also offering foreigners an option to retire in the Philippines.

The tourism industry generated $2.1 billion in revenue with 2.6 million tourist arrivals in 2005. Domestic travelers reached 13 million with expenditures amounting to $3 billion in the same year. Aside from the enormous revenues, employment generated (direct and indirect) during the year reached 3 million. Come 2010, tourism statistics are expected to double. International arrivals and domestic travelers are expected to reach 5 million and 25 million, respectively. Combined revenues from the two are projected to reach $10.9 billion, with employment generation expected to increase to 7 million. By 2030, foreign tourist arrivals and domestic travelers are projected to reach 11 million and 55 million, respectively. As a result, tourism receipts are expected to reach combined revenues of $29.8 billion and generate 14 million in direct and indirect employment.

According to a workshop held by the Joint Foreign Chambers of Commerce in the Philippines on October 5, 2006, the tourism, health care and retirement industries can attract an estimated foreign direct investment of $3 billion annually from 2007 to 2010. The question, however, is how to draw these investments in.

In the tourism sector, the presence of modernized facilities and other infrastructures are crucial in sustaining robust growth and development. Growth relies on better road networks, highways and airports to bring tourists to their destinations. On top of these concerns, the country also needs to be more investor-friendly by promoting the passing of, and eventually, enforcing of laws that will advance the progress of the aforementioned industries.

Executive Order (EO) 500 which declared open skies in Clark, Pampanga could have been an effective tool in stimulating more robust growth in the country. However, even before it was implemented, EO 500 has been reversed with the signing of EO 500-A on August 22, 2006. This action is feared to weigh down the tourism industry by halting the entry of new foreign airline carriers at Clark, which more than tripled the volume of passenger traffic from 2004 to 2006.

Liberalization in retrospect

The country's quest for long-term growth from tourism and investment as well through the Clark and Subic international gateways were initiated with the issuance of

EO 253 calling for "open skies" in Subic Bay International Airport and Diosdado Macapagal International Airport in 2003, followed by the Liberalized Charter Program of the Civil Aeronautics Board (CAB) in 2005. The Program allowed airlines, upon application for permits, to fly in commercial passengers to and from certain routes for a period of six months.

The initiative enhanced entry and operation of low-cost carriers such as Singapore-based Tiger Airways and Malaysian Air Asia in the zone. Hotel occupancy rates went up by 90 percent, according to Mr. Villanueva, president of Clark Investors and Locators Association (CILA). The initiative also encouraged more visitors from the Association of South East Asian Nations (ASEAN) member-countries as international budget airlines in Clark fly only to and from these countries. Ultimately, the Program gave rise to Clark as the Philippine hub for regional low-cost airlines.

Figure 1. Diosdado Macapagal International Airport

Source: http://www.skyscrapercity.com

Realizing the immense potential from developing Clark Field as an international gateway, President Arroyo signed Executive Order (EO) 500 on January 27, 2006. The law liberalizes air access of international air carriers to the Diosdado Macapagal International Airport (DMIA) and the Subic Bay International Airport (SBIA), and gave airlines some assurance of permanent permits to operate there. In particular, EO 500 directs the Philippine air negotiating panel, chaired by the Transportation Department, to begin air talks with Singapore, Malaysia, Thailand and Korea "to formalize the special charter permits granted by CAB into permanent air entitlements."[8]

Figure 2. Subic Bay International Airport

Source: http://www.skyscrapercity.com

EO 500 also allows ASA-covered carriers to "apply for a waiver of any restriction or limitation on capacity, type of aircraft or non-cabotage traffic rights."[9] This means that

[8] These entitlements are formally known as Air Service Agreements (ASA), under which countries and the Philippines designate carriers that can operate the routes between them. A typical ASA provides for at least nine air freedoms.

[9] Cabotage could be in the form of consecutive cabotage – the right to carry passengers between two domestic points within a foreign nation – or stand alone cabotage – the right to transport cabotage traffic on a service performed entirely within the territory of the granting state.

carriers could use DMIA without restrictions as to the number of flights and seats per week.

Policy reversal

One of the shortcomings of EO 500 was the limited lifting of restrictions indicated in the ASAs only for designated carries, or airlines recognized by their countries. Capt. Solis, a member of the 1995 Philippine negotiating panel, once stated that it is the secondary or unrecognized carriers that should be targeted first by DMIA in order to benefit most of the overseas Filipino workers (OFWs) working in the Middle East, give that Philippine Airlines have practically no flights to the region. In addition, the designation process in most countries is thus far complicated and tedious, which then somehow post an entry barrier for secondary airlines. As such, amending EO 500 to allow secondary carriers would have been optimal for DMIA.

On August 22, 2006, President Arroyo amended EO 500 by signing EO 500-A, even before the former was implemented. EO 500-A essentially reverses EO 500. For example, EO 500-A specifies that only designated airlines from 60 countries with existing Air Service Agreements with the Philippines can operate at DMIA and SBIA, but limited to only third and fourth freedoms. The third freedom pertains to the right to carry passengers from the home country to another country while the fourth freedom relates to the right to carry passengers to the home country from another country.

EO 500-A essentially removes the fifth freedom granted to airlines. The fifth freedom or the "right to network" provision under the 1944 Chicago Convention allows airlines to pick up passengers in either Clark or Subic, proceed to a third country before returning to their home country. This provision is important to airlines that fly routes with limited passengers because it is not economically viable to fly a Philippines-Macau route, for instance, as an aircraft is almost impossible to fill with passengers bound for Macau. But the 5th freedom provision allows an airline to carry a few passengers bound for Macau and passengers bound for Singapore.

It is feared that EO 500-A will not only cripple the DMIA or Clark-Subic Special Economic Zones but will also hamper the potential of tourism in contributing robust growth to the economy. For one, EO 500-A imposes restrictions on the available airline market for the DMIA, which therefore will make the said airports less attractive for foreign carriers. EO 500-A will stop the progress of DMIA in becoming a regional hub for ASEAN.

Consequently, EO 500-A will hold back, if not decrease, the growth in the number of tourist arrivals in the country. Officials of the Clark International Airport Corporation (CIAC) once stated that "DMIA now hosts 77 passenger and cargo flights weekly and that if EO 500-A is scrapped, the number is expected to grow.

Investment growth was also threatened with the signing of EO 500-A. According to Mr. Victor Luciano, CIAC president, the worst that EO 500-A could do is to restrict the expansion plans of Tiger Airways a Singaporean company since it is not a designated carrier like other foreign airlines currently operating at DMIA. Tiger Airways deferred setting up its $300M regional hub and base at least six new Airbus 320s for Asia-Pacific operations at Clark. Tiger Airways was estimated to generate some 10 million passengers over a five-year period and expand its network to cover routes between Clark and Thailand, Macau, China, Taiwan, Korea, Malaysia and Indonesia and, possibly, Vietnam and Australia, said Mr. Luciano.

It is not hopeless

Modernization in facilities and other infrastructures remain critical in realizing the potentials of the tourism industry. As such, modern airports and road networks have to be built and operated to meet current and future demand. Tourist destinations should be kept environmentally sustainable.

The government should also concentrate tourism development promotions in a few strategic areas, such as Subic and Clark, along with Cebu, Western Visayas and Davao. In this view, the government must also address the need to make the country friendly to investors. As such, the government must be true and consistent with its agenda of liberalizing aviation policy first at Clark and later at other key tourism priority destinations. They can do this by rescinding EO 500- A, or amending it with EO 500-B.

The Joint Foreign Chambers of the Philippines (JFC) have urged the government to rescind EO 500-A and instead pursue a liberal aviation policy to help DMIA in Clark to achieve its goal of becoming a premier international hub by issuing EO 500-B, which would seek to make permanent CAB's mandate to grant freedom rights to foreign carriers, including the 5th and 7th freedoms.[10]

The JFC also argued that EO 500-B would complement the proposed Subic-Clark-Tarlac Expressway (SCTEx), which will provide exporters located in Subic Freeport and in Tarlac with improved access to the DMIA. In effect, the arguably underutilized potential of Clark as an international gateway and the Subic Freeport will then be exploited, and ultimately unlock the economic potential of Central and Northern Luzon.

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The Controversial NAIA IPT-3

The Subic-Clark-Batangas (SCB) Corridor produces more than half of the country's gross domestic product. According to the October 5, 2006, Workshop on FDI, the construction of infrastructure and modernization of facilities in the Corridor will attract annual foreign direct investment of up to $2.3 billion from 2007 to 2010. A $100 million investment alone is expected to generate 18,720 jobs in direct employment and 10,080 jobs in indirect employment.

Infrastructure developments in the corridor, particularly in transportation, will spread development and provide opportunities for growth in areas other than Metro Manila. The foreseen interconnection between Subic and Clark, and Batangas to Metro Manila are expected to attract businesses and also housing projects, where land is cheaper and the lifestyle conducive to families. This will also improve mobility among commuters and thus, will encourage the dispersal of Metro Manila population towards Central and Southern Luzon.

The hard infrastructure projects for the SCB Corridor are basically for improving the transport system, particularly air transportation. One part of the plan is the Ninoy Aquino International Airport International Passenger Terminal 3 (NAIA IPT-3), which is expected to further enhance the service level of the NAIA system. The new terminal can accommodate 13 million international passengers per year with 28 contact bridges. The public has yet to see the opening of the NAIA IPT-3 despite the accomplishment of construction in 2002 due to fraud, bribery and corruption controversies hounding the contract.

NAIA 3: A Backtrack of Events

The construction of the NAIA-3 dates back in 1989 when the Department of Transportation and Communication with ADB technical assistance funding hired Aeroport de Paris (ADP) to draft a study on the projections of the tourist arrivals in 2010 at the NAIA. ADP recommended the expansion of the NAIA facility to accommodate at least 13 million passengers until 2013. In 1993, the Asia's Emerging Dragon Corporation (AEDC) consortium formed by six Filipino-Chinese businessmen (Lucio Tan, John Gokongwei, Andrew Gotianun, Henry Sy, Jr., George Ty and Alfonso Yuchengco) informed then President Fidel V. Ramos of its willingness to build and operate a new airport.

AEDC submitted a proposal for the construction of the NAIA IPT-3 under a build-operate-transfer deal with the Manila International Airport Authority (MIAA) in 1994. As such, AEDC won the status as original proponent of the project, which earned it the right to match any winning bid by another proponent. Other bidders included People's

Air Cargo and Warehousing Co., Inc. (Paircargo) of the Cheng family, Philippine Air and Grounds Services, Inc. (PAGS), and Security Bank Corp. AEDC and Paircargo both offered $350 million however, Paircargo made a better offer of P17.75 billion in guaranteed revenues for the Philippine government compared to AEDC's P135 million. AEDC failed to match the offer and Paircargo was declared the winning bidder in December 1996.

The Philippine International Airport Terminals Co., Inc (Piatco) was set up by Frankfurt Airport Services Worldwide AG (Fraport) of Germany, Sojits Corp. of Japan, and SB Airport Investments of Singapore, and Paircargo two months after Paircargo won the deal. Piatco and the government signed a concession agreement to operate and maintain NAIA IPT-3 for 25 years, with the option to extend for a period not exceeding 25 years.

In 2002, when the newly-finished terminal was supposed to open, President Gloria Macapagal-Arroyo made a statement that the government would not honor its contract with Piatco due to overpricing and flawed bidding. A year after, the Supreme Court declared the contract with Piatco void for being "contrary to public interest and violative of bidding rules and the Build-Operate-Transfer Law." Several Piatco, Fraport and government officials, and other private individuals were indicted by the Office of the Ombudsman in September 2004.

Figure 1. NAIA IPT-3

Source: Newsbreak (www.newsbreak.com.ph)

Piatco filed an arbitration case in December 2004 with the International Chamber of Commerce-International Court of Arbitration (ICC) in Singapore for $500 million in compensation following the government's expropriation of the facility a month before. Expropriation is an inherent power of the state under the principle of eminent domain, although this is limited by the Bill of Rights, hence the government cannot forcibly take over the terminal without the payment of "just compensation." Fraport also filed an arbitration case in the World Bank-International Center for the Settlement of Investment Disputes (ICSID) in Washington D.C. for $425 million worth of compensation.

In January 2005, Judge Henrick Gingoyon of Pasay City Regional Trial Court (Pasay City RTC) Branch 117 ordered the government to pay an initial $62 million or P3 billion as just compensation to Piatco as the builder and original owner of NAIA IPT-3.

The high court issued a temporary restraining order against Judge Gingoyon's decision upon the Office of the Solicitor General's request for reconsideration. Twelve months later, the Supreme Court upheld the decision of the Pasay City RTC. It ordered the government to pay Piatco the determined amount of initial compensation before it exercises its right of ownership over the facility.

The international arbitration court in Singapore ruled in favor of Piatco and has ordered the Philippine government in August 2006 to give up possession of NAIA IPT-3 to Piatco until a valid writ of possession is issued by a Philippine court. The tribunal recognized the Supreme Court's decision in December 2005, which orders the government to pay Piatco an initial compensation before it can take over NAIA IPT-3.

To date, the government is trying its best to contest PIATCO's claims for a total of $565-million compensation by the Philippine government before the ICC. It has urged PIATCO to submit detailed records of how much was spent for the construction of the new airport terminal. Lawyers helping the government say that PIATCO's reluctance to release the documents, even after being ordered to do so by the arbitration panel, may help the Philippines win a favorable ruling. The government won a writ of possession from the Pasay RTC and has said it is now preparing for a so-called "soft opening" of NAIA IPT-3 with just one or two airlines in the first quarter of 2007.

After the Supreme Court declared the airport contract null and void, Fraport went to ICSID and alleged that its investments were being unfairly treated by the Philippine government. The government nevertheless has been consistent in its position that the contract was obtained and implemented through various acts of corruption and bribery, thus the two groups' assertions should be inadmissible.

The government said that Piatco and Fraport cannot explain claims amounting to $565 million and $425 million, respectively. Thus far, only $275 million of the total claim of Fraport has been paid to Takenaka Corp., its subcontractor. Adding some $30 million in "soft costs" still leaves an unexplained gap of $120 million.

According to a *Newsbreak* article, the soft costs were attributed to Fraport's alleged illegal activities. One case is when Fraport paid a political operator $850,000 in order to obtain government's approval of Fraport's share purchase of a company owned by the Cheng family, its local partner in the consortium, within only 12 days. The approval led to corporate layering that would allow Fraport to effectively own 61 percent of Piatco.

Revenues Minus Expenses = Losses

The government is still optimistic that it will meet its March 2007 opening target of the mothballed NAIA IPT-3; otherwise, it should stand to lose more money. Since the government filed for its expropriation petition at the Pasay City RTC in December 2004, the MIAA has been spending an average of P1 million for the monthly power expenses of

the NAIA IPT-3. Aside from electricity, MIAA is also paying for the water and for the security of the terminal.

Nevertheless, the government will offset its losses according to MIAA with projected earnings of almost P3 billion in gross revenues in 2007. This is under the assumptions that NAIA IPT-3 will start operating by March 2007 and that all international flights will use the new terminal while the domestic flights will use Terminal 2 (NAIA-2). The NAIA IPT-3 expects to earn P4.7 billion by 2008 and P5.6 billion by 2012.

The MIAA has also unveiled its plans to lease the old Terminal 1 due to the perceived need for a bigger terminal that can accommodate the airlines. Rent costs about P600 to P1,200 per square meter. Overall, the three terminals and other sources of revenues like the taxiways, hangars and cargo terminals are expected to earn a total of P7.59 billion next year and P12.2 billion after five years.

Recommendations

Given the importance of infrastructure developments in the SCB Corridor, the Japanese Chamber of Commerce and Industry of the Philippines (JCCIPI) is urging the Philippine government to immediately implement its plans for the area. In its recent study on the investment climate in the Philippines, the JCCIPI said that in order to improve its position against neighboring countries, such as Thailand, the government "needs to concentrate its infrastructure funding on the development of the Main Logistic Corridor" which connects Subic Bay and Batangas areas through Manila.

Previous studies conducted state several challenges that hinder the progress of infrastructure developments not only in the SCB Corridor but the whole country. Problems identified include less private sector participation in the implementation of infrastructure and services; weak institutional foundation; lack of a monitoring and maintenance system of existing infrastructure.

The controversy behind the construction and opening of NAIA IPT-3 is just among the many proofs of problems encountered in establishing infrastructure in the Philippines. The battle between the government and the Piatco consortium may not be resolved at the moment but what's important is that the government will maintain its original goal of providing reliable air transportation system for the commuting public.

In order to let infrastructure developments progress, problems identified should first be resolved. In the Workshop on FDI on October 5, 2006, it was pointed out that there are numerous actions that should be taken, especially by the government, in order to attract foreign direct investment in the SCB Transport Corridor.

On the legislative front:

(1) The government should amend the Build-Operate-Transfer (BOT) law to expand modes of private sector participation. The BOT is a contractual arrangement whereby the project proponent undertakes the construction, including financing, of a given infrastructure facility, and the operation and maintenance thereof. The project proponent transfers the facility to the government agency or local government unit concerned at the end of the fixed term;

(2) The government may acquire land and other real property needed as right-of-way for its infrastructure projects, through donation, negotiated sale or expropriation. Thus, the government must establish an effective measure of land expropriation;

(3) To avoid confusion among investors and contractors, the government should remove the issues between regulatory bodies, specifically on conflicts of interest; and

(4) Foreign presence in the construction industry is largely limited to joint ventures with local firms or large scale infrastructure projects under the BOT law. To encourage entry of foreign investors, the 60-40 equity restriction should be removed.

In addition, administrative- and financial-related policies include:

(1) Issuance of an Executive Order for a PPP legal-policy framework;

(2) Improve central oversight of the planning and coordination of investments;

(3) Continued specific reforms in key sectors –particularly power, aviation, roads, ports and water – to promote competition;

(4) Availability of political risk cover;

(5) Access to medium- to long-term domestic capital funds; and

(6) Sustained fiscal performance.

Addressing the above challenges will be proactive steps to achieving the development goals for the region and avoid the occurrence of another controversy like NAIA IPT-3.

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