1. Background

International air transport is a critical pillar in the overall competitiveness and sustainability of the Philippine economy. The availability of an efficient network of air transport services to move goods and people is a major attraction for investments in high value production and in service-oriented facilities. International air connectivity is the major infrastructure that will harness the widely-recognized yet least appreciated strategic geographical location of the country for tourism and high value trade and logistics in the Asia-Pacific region. About 70 percent of the value of Philippine exports is moved by air. Ninety-eight percent of visitor arrivals arrived by air. The network of 8 million Overseas Filipinos including the 3.5 million Overseas Filipino Workers (OFWs) travel by air to and from their place of work. The country has an existing and extensive network of international and domestic airports and most of which remain underutilized.

2. Policy Developments

The Republic Act No. 776 also known as the 1952 Civil Aeronautics Act of the Philippines established the laws governing the economic (Civil Aeronautics Board) and technical (Civil Aeronautics Administration) regulation of the industry. Executive Order No. 125 and 125-A bestowed to Air Transportation Office (ATO) the function of establishing and prescribing rules and regulations for the inspection and registration of all aircraft owned and operated in the Philippines and all air facilities. In June 1959, the government passed the Republic Act No. 2232 that designated the Philippine Airlines as the national flag carrier of the country. In 1973, the Marcos administration established a one-airline policy in both the domestic and international routes with the passage of the Letters of Instruction No. 151 and 151A. The monopoly of PAL was challenged with the issuance of Executive Order No. 333 by the Aquino administration.

The Reform Period

Under the Ramos administration, the CAB started to take a pro-active stance in introducing competition in the international routes by negotiating for capacity expansion as reflected in the changes in airline designation and higher traffic rights.

The government implemented a series of policy changes to promote development and implement liberalization

- Executive Order No. 62 (series of 1993) to accelerate the sound and balanced conversion into alternative productive uses of the Clark and Subic military reservations and their extensions by mandating under section 2 of Republic Act No. 7227 of 1992 by mandating the Bases Conversion Development Authority to prepare and implement a comprehensive and detailed development program for the former Clark Air Base as a major civil aviation complex for international passenger and/or cargo and the former Subic Naval Base as a special economic and free-port zone ensuring the free flow of goods and capital in accordance with prescribed rules.
- Under Executive Order No. 80 (series of 1993) the government established the Clark Development Corporation and the Board of Directors of the BCDA has promulgated a policy of expanding air services to the airport through its development as a major cargo hub for the Asia-Pacific region.
• On April 28, 1994, it issued Executive Order No. 174 designating the Clark Special Economic Zone as the site of the future premiere international airport. All these policies aimed to realize the development agenda of the administration to position the Philippines as the hub for tourism and transport.

**The major policy on liberalization (Executive Order No. 219) was issued in 1995.** The principal provision was to make the users of air services and not the airlines, the main constituency in determining government policy. The EO allowed the entry of competitors like Cebu Pacific, Asian Spirit and Air Philippines to challenge PAL’s position in the industry.

**The domestic passenger market was the principal of liberalization under Ramos.** There was the wider range of choices in airlines, flights, fares. The same policy provided the opportunity for the new local carriers to be designated as official carriers in international routes. However, it did not completely create an enabling environment for them to easily secure additional traffic rights negotiated by the CAB or to use existing entitlements. The use of the grandfather clause or argument by incumbents tends to deprive new entrants of the chance to compete. Furthermore, the government was not pro-active enough to negotiate with revenue-generating markets. The delay in the promulgation of the Implementing Rules and Regulations of EO 219 did not secure the spirit and benefits of the liberalization policy. Starting 2001, the CAB initiated improvements in the air access infrastructure between the major markets and the Philippines, particularly the gateways of Cebu, Davao and the Diosdado Macapagal International Airport (DMIA).

Under President Arroyo, the main development is the increase in competition in international routes and the emergence of the Clark International Airport, called the Diosdado Macapagal International Airport (DMIA).

On December 3, 2003, the Executive Order No. 253 was issued providing the expansion of air services to the Diosdado Macapagal International Airport (DMIA) and the Subic Bay International Airport (SBIA). This policy opened the DMIA and the SBIA to international air cargo operators and regarded the increase in commercial air cargo as an enhancement of trade and investment opportunities for the Philippines. The IRRs were approved and issued in March 2005 and amended under CAB Resolution No. 16 (series of 2005). The liberalized charter policy under CAB Resolution No. 23 (series of 2005) aimed to enhance the development of the regional gateways. This enabled Asiana Airlines to develop the Korean

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1 Some routes are served by only one niche carrier since the larger carriers concentrate in the trunk routes.
2 This was evidenced in the abrogation of the RP-Taiwan agreement in 1999. The implementing rules and regulations of EO 219 were finally passed in 2001.
3 The CAB negotiated for higher capacity between the Philippines and countries such as South Korea, Japan, Singapore, China, Vietnam, Qatar and United Arab Emirates.
4 Air access to the DMIA and SBIA is declared as a development route. The authority to operate such route may be granted unilaterally without any restriction or limitation on capacity, type of aircraft and non-cabotage traffic rights other than those that may be required by considerations relating to airport security and aviation safety. This authority shall be granted without prejudice to any right or privilege of the applicant under Philippine law, including any Air Services Agreement (ASA) or similar air services arrangement. Foreign air carries designated by states with an ASA with the Philippines that already grants such carriers the right to operate air cargo services to and from the DMIA and SBIA may apply for a waiver of any restriction or limitation on capacity, type of aircraft or non-cabotage traffic rights imposed by the relevant ASA on their right to operate such air services. Such waiver shall be granted provided its scope does not extend beyond the commercial and technical requirements for the operation of air services to and from the DMIA and SBIA.
tourism market and low cost airlines like Air Asia and Tiger Airways to create new markets and provide alternatives to passengers. On June 2005, President Arroyo declared the development of the Clark-Subic corridor as part of her ten-point legacy agenda. The benefits created by this liberalized charter policy for the DMIA became the basis for the issuance of Executive Order No. 500 (series of 2006). The liberalized charter policy and the EO 500 have made the DMIA one of the premier gateways. The sustained growth of the traffic and business coupled with investments in the airport infrastructure can accelerate the transformation of the DMIA into a major logistics hub in the region (see Box 1).

A total of five international airlines (3 foreign and 2 local) served as DMIA’s major partners in 2009. The foreign airlines were Tiger Airways, Air Asia and Asiana Airlines. The local carriers were Cebu Pacific Air and Zest Air. The domestic connections were provided by Cebu Pacific, Zest Air and SEAir. In 2009, the DMIA handled 558,937 international passengers, representing growth of 13.9 percent from its level in 2008, despite the global financial crisis.

From May 2007 to December 2009, the government conducted a total of 22 air talks with various countries, majority from the Asia Pacific region, home to the revenue generating markets for tourism and trade. Entry barriers in terms of air traffic rights have significantly been reduced as a result of these air talks. The major beneficiary was DMIA. Prior to 2007, Clark’s separate entitlements were about 600,000 seats (throughput) per year. In 2009, Clark’s air traffic rights were estimated to be around 9.8 million seats (throughput) per year. Given this basic infrastructure, the challenge for Clark now is the utilization of traffic rights.

Table 1 Air Talks – May 2007 to December 2009

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Air access to and from the other secondary gateways like Mactan-Cebu and Davao also improved significantly. Under the new RP-Australia agreement, officially designated carriers can mount unlimited capacity between Mactan-Cebu and all points of Australia except Sydney, Melbourne and Brisbane.

3. **Recommended Policy, Regulatory and Institutional reforms**

   1. **Manila definition be broadened to include Clark**

This policy involves defining Manila as a destination point in the air service agreements to include the NAIA, DMIA and SBIA. This is patterned after the two and three airport destination model of the states of New York, Washington DC, or the two airport destinations of London, Paris, Jakarta and others. The JICA is currently working with the Department of Transport and Communications in pursuing the Greater Manila Airport study.

   This policy aims to accelerate the development of Clark into the premier gateway of the Philippines and the infrastructure to support it. In June 2005, the President of the Philippines declared as one of the ten-point legacy agenda of this Administration, the development of Clark – Subic into the best international service and logistics center of the region. Furthermore, the NAIA faces the same challenges as many older airports in Asian Capitals whose populations have grown rapidly in recent decades and have encroached into areas surrounding NAIA airport denying NAIA any room for any airport expansion. The passenger terminals of NAIA both domestic and international have also reached their maximum capacity levels since 2006 and even if Terminal 3’s capacity is put to use, it will also reach its maximum capacity level by 2010. This recommendation also aims to make DMIA reap the benefits from the ASEAN Multilateral Air Agreement (AMAA) at an earlier period. The ASEAN Agreement provides for unlimited 3rd and 4th Freedom Rights for passenger traffic between capital cities of the ASEAN and further putting into effect Full Liberalization of Air Freight Services among ASEAN cities. It can also be argued as a justification that "CAPITAL GATEWAYS" are now not necessarily located within the physical boundaries of the "Capital " like the case of Bangkok or Kuala Lumpur. If we are to push for DMIA as the premier gateway of the country for the long term, this is the fastest way to lay out the legal fundamentals of "ACCESS RIGHTS ".

   2. **All air agreements to be revised to “all points”**

Another strategy to accelerate the development of secondary gateways is to leave the route design and city pairing to the business judgment of the airline management and not to the government negotiators. One way to achieve this is to negotiate new traffic rights to be exercised to/from all points in the Philippines. All existing ASAs that still carry traffic rights provisions to specified Philippine gateways can also be amended and replaced to just “points in the Philippines,” especially if the utilization of traffic rights is already high.
This situation can open the doors to regional carriers who want to reduce competitions by reducing the numbers of identical parallel sectors or identical city pairs. This strategy will also aid LCCs who are designated national carriers to create routes within a bilateral agreement without having to parallel the route sectors of the dominant carrier of his country.

3. ASEAN Open Skies

This agreement is not a new initiative or target. Rather, it is an important component of the overall economic integration of ASEAN, since transport links are critical to bringing down barriers to trade, and facilitating change.

Open Sky leads to city pair markets being more open to new competitors, and it also leads to existing competitors having more scope to compete and to offer better deals to travellers. Overall, more competition and trade will lead to net gains in most cases. However the distribution of these gains can differ, and sometimes one group loses out. Thus airlines can lose out from facing more competition— but the losses they face are less than the gains which are enjoyed by their passengers. The benefits include tourism revenues, government revenues and employment. In addition to these economic impacts, liberalisation can also impact on defence and security, health and safety, the environment, and on foreign relationships.

In principle, the unified aviation market by 2015 means that ASEAN airlines can fly unlimited third, fourth and fifth freedom traffic rights among any cities within the ASEAN region. For example, Philippine carriers will be able to fly unlimited flights from Manila to Singapore to Bangkok, or from Cebu to Penang to Phuket.

This unified aviation market by 2015 will be the result of the 22 year liberalization process in ASEAN aviation, embodied in the ASEAN Roadmap for the Integration of ASEAN: Competitive Air Services Policy. Based on this implementation timeframe:

- 1993 – limited Open Skies Agreement by Indonesia, Malaysia and Thailand to promote a growth triangle among themselves.
- 1994 - the creation of another growth triangle area by Indonesia, Brunei, Malaysia and the Philippines, now known as the BIMP-EAGA growth area, that allowed unlimited 3rd & 4th freedom rights within the growth area.
- 1999/2000 Limited 5th freedom rights granted among Brunei, Indonesia, Malaysia and the Philippines within the BIMP-EAGA growth area.
- 2004 – Singapore, Thailand, Brunei Multilateral Open Skies Agreement
- 2005 – Unlimited 3rd, 4th and 5th freedom rights for passenger flights for all designated points within the ASEAN sub-region.
- 2006 – Unlimited 3rd and 4th freedom rights with increased tonnage and additional designated points stated in the ASEAN MOU for air freight services. Unlimited 3rd and 4th freedom rights for passenger traffic in at least two designated points within the ASEAN sub–region. Unlimited 5th freedom rights for all designated points within the ASEAN sub-region.
- 2008 – Unlimited 3rd and 4th freedom rights for passenger traffic for all ASEAN capital cities. Unlimited 5th freedom rights for at least 2 designated points in each country between ASEAN sub–region. Full liberalization of air freight services.
- 2010 – ASEAN – wide liberalization of scheduled passenger services, unlimited 5th freedom for ASEAN capital cities.
- 2015 – ASEAN OPEN SKIES - unlimited third, fourth and fifth freedom traffic rights among any cities within the ASEAN region
This timeframe is captured in the following implementing Protocols which form integral parts of the Agreement:

a) Protocol 1 Unlimited Third and Fourth Freedom Traffic Rights Within ASEAN Sub-Region;
b) Protocol 2 Unlimited Fifth Freedom Traffic Rights Within ASEAN Sub-Region;
c) Protocol 3 Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Sub-Regions;
d) Protocol 4 Unlimited Fifth Freedom Traffic Rights Between ASEAN Sub-Regions;
e) Protocol 5 Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Capital Cities;
g) Protocol 7 Unlimited Third and Fourth Freedom Traffic Rights Between Any ASEAN City
h) Protocol 8 Unlimited Third, Fourth and Fifth Freedom Traffic Rights Among Any Cities within the ASEAN region

Open Skies will now enable the ASEAN airlines to be able to freely respond to market demand and/or create new markets as long as airport infrastructure capacity can allow it. ASEAN tour operators and travel agents can now develop more packages that can bring non-ASEAN tourists to more interesting gateways in the region. Furthermore, the competitive airline markets will also benefit ASEAN nationals and travelers through lower fares and greater accessibility.

4. Airport Infrastructure

The Philippines lags behind its Asian neighbors in terms of airport infrastructure, thus contributing to a negative and uncompetitive image of the Philippines as a premier tourism destination in the region. The Ninoy Aquino International Airport (NAIA) faces the same challenges (i.e. space restrictions) as many older airports in Asian capitals whose populations have grown rapidly in recent decades.

Terminal 3 should already be fully operated. However, the capacity will still be small to accommodate the potential growth given the regional prospects and opportunities. Terminal 3 itself can handle wide-body docking and parking. It’s the taxiway 13/31 that cannot as it’s not wide enough and distant enough from Runway 13/31. If RW 13/31 is used then both the taxiway and the RW13/31 need to be closed for operations. This will then render the domestic terminal use (MDT) inoperable or congestion will transfer to RW06/24 as even General Aviation aircraft need to use the international runway. Foremost of the problem is the refueling facility as JOCASP (fuel depot) is on the other side so fuel trucks need to cross active runways and taxiways to get to T3. PAL and CEBUPAC can manage refueling as they have their own fuel depot though limited, located in the domestic airport side so they can reach T3 without crossing the international area. T3 is at this junction better suited for a PAL and CEBPAC operations combined and T1 and T2 for other airlines provided access to it can be resolved. A tunnel under RW13/31 seems to be the most logical solution. However all these “patch – up” solutions will become ineffective and a waste of money as these patch up solutions will just postpone the inevitable.

Thus, it is recommended that the national government highly prioritize the development of support infrastructure (e.g. high-speed rail) to decongest Manila and develop Clark as the future premier gateway. In the interim, at least in the next five years, Clark’s assets should continue to be utilized to service the low cost carriers plus legacy carriers interested to develop new markets.
5 Business and Investment Climate

One major barrier to the utilization of air traffic rights by foreign airlines is the discriminatory tax policy imposed on foreign airlines only. The foreign airlines are burdened with the 3 percent Common Carriers Tax and 2.5 percent Gross Philippine Billings tax, both based on the global sales of these airlines. This policy, which is not an international practice, is a major reason behind the pull-out of foreign carriers, particularly the long haul carriers with global networks. Another cost of doing business issue is related to the CIQ overtime charges, taxes and fees not imposed elsewhere and which further worsen the image of the Philippines as an investment destination for foreign airlines.