



***Aviation in Transition:
Challenges & Opportunities of Liberalization***

Session 4: Safeguards and Sustainability

Presentation by:
Robert Lim
Vice President — Legal Affairs
Philippine Airlines

**THE ODYSSEY
OF A
NATIONAL FLAG CARRIER
IN A LIBERALIZING AIR
TRANSPORT INDUSTRY**

**ROBERTO C.O. LIM
Philippine Airlines, Inc.**

Fax: (63-2) 867-45-63

Email: rol_legal@pal.com.ph

www.philippineairlines.com

The purpose of my talk is to share with you some personal thoughts on the continuing relevance of the national flag carrier from the perspective of the Philippines a small archipelagic country in Southeast Asia.

I would like to express my thanks to the organizers of this Seminar for the opportunity to share some viewpoints and also to articulate the aspirations and apprehensions of developing countries in this difficult period of the aviation sector. The views expressed however should not in any way be considered to reflect the official view of the airline.

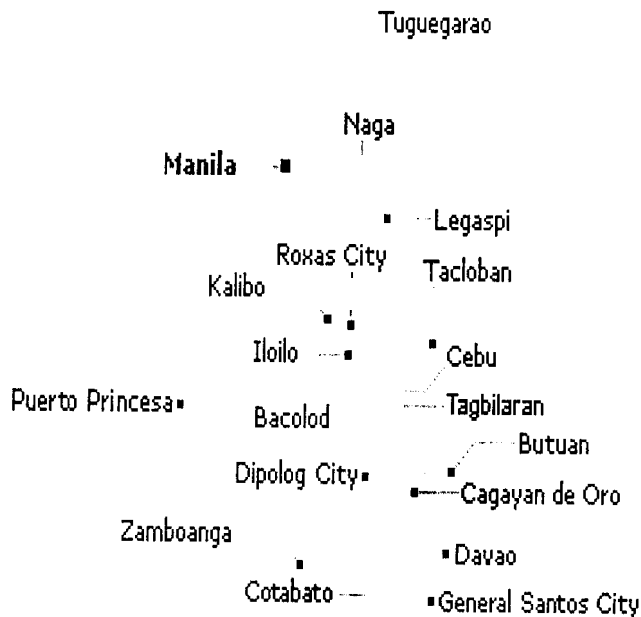
DOES A SMALL COUNTRY NEED A DOMESTIC AIRLINE?

The Philippines is an archipelagic nation composed of 7,000 islands and is classified as a developing economy. Does it need a domestic airline? The answer will logically be in the affirmative. Air highways are vital to establish the connectivity of people and the movement of cargo to cities separated by water (Table 1) . If we take Singapore as an example, the answer will logically be in the negative because the small territory of the country over which sovereignty is exercised by the State makes it difficult to justify the existence of a public need and convenience to be served.

•Serves 18 cities

•Carries an average of 8,600 passengers daily

•Operates an average of 72 flights or 36 round trips per day



DOES A SMALL COUNTRY NEED AN INTERNATIONAL FLAG CARRIER?

If the question asked is: does a small country need an international airline with an international network which spans the globe? The response becomes more complex because the physical size of the country alone is no longer of singular importance. Other factors come into play in the government's decision making process.

In the Philippine context, there are constitutional and legal directives which effectively mandate a preference for the continued existence of a national flag carrier.

Art. II Sec. 19 of the Philippine Constitution provides that "*The State shall develop a self-reliant and independent national economy effectively controlled by Filipinos.*" Air transport is a significant contributor to national development. The industry provides the connectivity of millions of people to various destinations and the movement of millions of dollars of goods and services to markets worldwide. Air transport is an essential tool to promote trade, commerce, investments, employment, technology transfers, and tourism. Since the State policy commands a nationalist approach to economic development national flag carriers should participate in international air transport to secure the benefits for the home country.

Art. XV Sec. 10 par. 2 of the Philippine Constitution provides that "*In the grant of rights, privileges and concession covering the national economy and patrimony the State shall give preference to qualified Filipinos*". The aerial domain is not only part of the territory of the Philippines, it also forms an integral part of the national economy. The national flag carrier should have the preference to develop and exploit the same.

In the Philippines, air transport is still regarded as a public utility instead of a normal economic activity. The Constitution directs the Filipinization of public utilities by requiring that any form of authorization for the operation of a public utility should be granted only to "*citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty per centum of the capital of which is owned by such citizens.*" Further, "*all the executive and managing officers of such corporation or association must be citizens of the Philippines.*"¹

Philippines statutes which embody norms and policies also serve as basis to recognize the continuing relevance of a national flag carrier and its role in national development. For example, Republic Act No. 2232 (1959) “An Act to Reactivate the International Air Transport Services of the Philippine Air Lines, Inc. and to Appropriate the Necessary Funds therefor” provides, to wit:

“Section 1. Declaration of Policy. – Because of the peculiar geographical location of the Philippines, it is vital to her security and defense and to the enhancement of her commerce that she should maintain her own international air operations.

The need for a Philippine flag carrier in air commercial is underlined by the current crisis in international relations;

x x x

And that, in case of such an eventuality, the foreign interest now controlling air travel to and from the Philippines will have to suspend their operations; thus isolating, in this respect, the Philippines from the other parts of the world.

Considerations of commerce also dictate that the Philippines maintain her own air lanes in the international field. The demand for air travel from this country to other points of the globe has increased enormously. Reactivation of Philippine air transport services would meet this demand; with resultant profit not to foreign-owned airlines but to the national flag carrier. Furthermore, the build-up in modern long-range aircraft, controlled by Filipino enterprises, would add to the stature and strengthen the position of the Philippines in world commerce and navigation; to say nothing of the training and experience which Filipino pilots, engineers and technicians would obtain in the process.” (Emphasis added)

Presidential Decree No. 1590 (1978), the PAL legislative franchise states in the first whereas clause viz:

“Whereas, the ownership, control and management of Philippine Airlines, our national flag carrier, have been reacquired by the Government.” (emphasis ours)

More recently in 1995, when the Philippine government established through Executive Order No. 219 its domestic and international civil aviation liberalization policy, the government envisaged Philippine flag carriers to participate in international air transport. Thus,

1.1 Carrier Designation. At least two (2) international carriers shall be designated official carrier(s) for the Philippines. However, if the designated carrier(s) do not service the total frequency entitlement of the Philippines under existing Air Services Agreements or other arrangements, then additional carriers(s) may be designated to operate such unused frequencies.

PAL was instrumental in actually facilitating liberalization of the domestic aviation sector. The State used the national flag carrier to subsidize the entry of new competitors. PAL was compelled to continue flying the missionary routes to serve the public interest while the new entrants concentrated on flying the profitable trunk routes without any corresponding obligations to serve even one missionary route.

In 1998, the government organized the Civil Aviation Consultative Council Centennial Aviation Conference which adopted a “Resolution Adopting the New and Updated Set of Policies, Goals, Strategies, Plans, Programs and Projects for Philippine Civil Aviation to Meet the Challenges of the Third Millennium.” The policy dealing with Philippine flag carriers is as follows:

“VII. PHILIPPINE AIR CARRIERS

- *Strongly and consistently support the Philippine air carriers, particularly in negotiations with foreign countries.*

Provide for an orderly and progressive competitive environment that is needed in order to enable the development of viable and competitive Philippine air carriers that will promote tourism, trade, employment and growth in air traffic”

VIII. DESIGNATION OF PHILIPPINE AIR CARRIERS

- *Designate an additional Philippine carrier or carriers based on criteria to be established for fitness, capability, market requirements and other considerations that include the competitive position of Philippine carriers vis-à-vis their foreign counterparts.”*

IX. GRANTS TO FOREIGN AIR CARRIERS

Continue to accommodate foreign carriers through the judicious grant of traffic rights where warranted by market demand, based on the international principle of reciprocity, defined as equal and realizable opportunities and value for the Philippines.

X. SAFEGUARDS FOR GLOBAL COMPETITIVENESS

Exert every effort to defend the rights of Philippine air carriers, starting with their right to fair and equal opportunity to access international markets. The Government shall work to remove artificial barriers to fair competition in the form of discriminatory practices adopted by some foreign countries”.

In the context of international law and relations, a national flag carrier must be seen as a necessity in order for States to claim their legitimate share of international air transportation and/or of the benefits thereof. Trade in international air services take place under a regulatory framework of bilateral air services agreements between countries. In order for States to acquire rights, negotiations of Air Services Agreement (ASA) between two (2) States must take place using two basic principles. The first is the sovereignty of States over its air space. Article 1 of the Chicago Convention codifies the sovereignty of nation over the airspace above their territories,

and Article 6 specifies that “no scheduled international air services may be operated over or into the territory of a contracting State, except with the special permission or authorization of that State.”² Since international public air law applies strictly to States, States continue by virtue of their sovereignty, to claim a national share of international air transportation and/or of the benefits thereof.

The second principle is the concept of reciprocity upon which countries exchange traffic rights. This means that two countries agree to exchange air rights in order for their respective carriers to gain equal access to each other’s markets. An integral part of such exchange is the designation of the flag carrier, which should be substantially owned and effectively controlled by its nationals, which will enable the designated State to enjoy the economic traffic rights granted under ASAs.

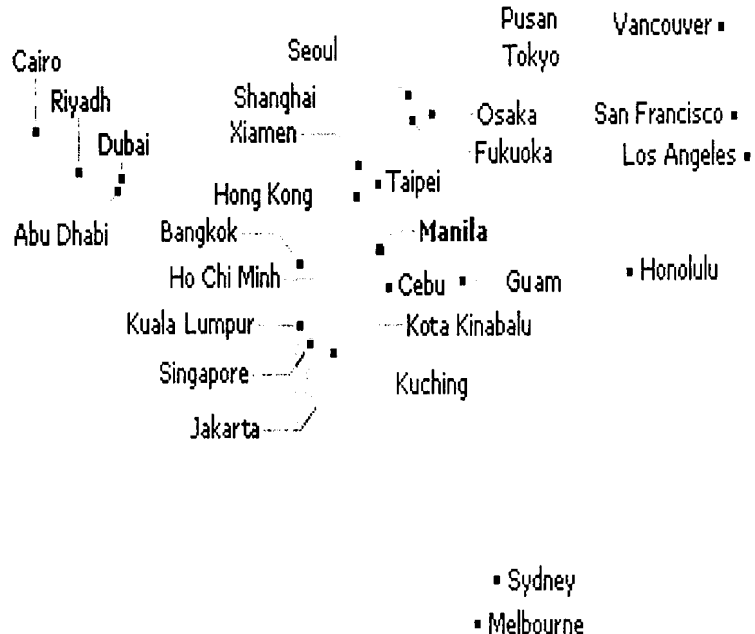
In economic terms, the Philippines is also justified in maintaining a national flag carrier because it contributes so much to the country. PAL as home carrier has expanded its trunk routes and extended the network efficiently for the country. (Table 2)

•Serves 27 cities
(20 direct and 7
through code-sharing
agreements)
in 17 countries

•Carries an average
of 7,000 passengers daily

•Operates more non-stop
flights from Manila than
any other airline

•Operates an average
of 38 flights or
19 round trips per day



PAL has its headquarters located at its home base, the Philippines. This creates stronger linkage and multiplier effects to the local economy than foreign carriers can ever match. A snapshot of the contributions of PAL to the economy is as follows:

1. PAL generates an average of USD815 million in revenues yearly, about 1% of Philippine Gross Domestic Product
2. PAL generates about 1.1 million visitor arrivals to the Philippines on an annual basis, supporting:
 - Employment of 7,500 persons by PAL
 - Employment of 1.08 million Filipinos in the tourism industry
 - US\$1.0 Billion in consumer expenditures
 - 4% of the Philippine Gross Domestic Product
 - US\$272 Million in taxes to the Philippine Government from the tourism industry
3. PAL offers 1.2 billion ton/kms of cargo capacity per year to service the agribusiness export industry.

As home carrier, PAL serves as an important source of technological advancement for the country and complements military and security concerns. A maintenance and engineering complex jointly owned by Lufthansa Technik and Philippine interests is based in Manila. PAL's aviation school is based in Clark, a former U.S. Air Base facility, which has been converted into a new airport gateway for the country.

As home carrier, PAL maintains a stable supply of air transport services for the country. Because of a shared destiny, the country is assured of continuity of services despite the vagaries of politics, economic relations, and other emergency crisis situations.

Servicing the Overseas Filipino Workers (OFWs)

The Philippines is the planet's top source of migrant workers. It is predicted that this natural market of PAL will continue to grow. Wired, a trade publication on new technologies observed:

“The Philippines is the forerunner of tomorrow’s distributed economy in supplying nurses, teachers, techies and sailors to the global village... with advances in transportation and telecommunications barreling ahead, it’s only a matter of time before the Philippine miracle becomes a standard for the new mobile global order, with skilled and unskilled labor commuting over multiple time zones to fill in labor gaps, zapping their wages homeward through space, re-entering for a new assignment.”

PAL, the privately owned national flag carrier which has been operating an international network even before World War II, has been maintaining international operations to service this natural market of 7.34 million OFWs scattered in nearly 200 countries, 97 percent of whom are land based. Around 890,000 OFWs were deployed in 2002.³ The national flag carrier which is already well-positioned to look after this natural market cannot abandon its international air transport services.

Servicing the Tourism Industry

Another reason for having a national flag carrier is the symbiotic relationship of the airline industry with tourism. The development of air transport is connected with that of tourism, and each has contributed to the other’s expansion.⁴

Tourism has often been cited to have a “*high-multiplier*” effect in the economy. Developing countries have been encouraged to select tourism development and promotion as an alternative over industrialization in achieving economic growth. Tourism is considered a bankable industry worldwide, with its share of global employment reaching 10% and its share of world GDP reaching around 15%. Tourism is the only major sector in international trade services in which developing countries have consistently had surpluses; the positive balance in their travel account has improved from \$6B in 1980 to \$62.2B in 1996. The East Asian market has been a major beneficiary, increasing its market share from 2.8% in 1960 to more than 15% in the 1990s. Developing countries account for nearly 30% of world tourism receipts. Growth rates in tourism are well above those for the general world output.⁵

Tourism – the lifeblood of Southeast Asia

Tourism is a major contributor to the services sector and the overall economic prosperity of Southeast Asia, estimated to be worth US\$26 billion annually. ASEAN nations account for about 40 million tourist arrivals annually, or 4.5 % of the global market.

The contributions to GDP within the region vary, with tourism providing a 4% share or US\$5.4 billion in Indonesia. Tourism makes up between 2 and 4% of the economies of Singapore, Malaysia and the Philippines and as much as 7% of total demand for goods and services in Thailand. ⁶

Tourism in the Philippines

98% of tourists visiting the Philippine islands travel by air

The tourism sector in the Philippines has been debilitated by terrorism. Amid the spate of kidnapping and bombings by Abu Sayyaf guerillas and travel advisories which labeled the country “*high risk*”, the country’s international arrival figures have fallen in each of the past three years. In 2001, visitor numbers fell by 5.3% to 1.7 million as September 11 decimated American traffic. US visitors account for 25% of the Filipino market.

The national flag carrier has played a resuscitating function for the country’s tourism industry. While foreign carriers have stopped flying to the Philippines and/or reduced frequency and redeployed their fleet to North Asia and to other regions, PAL as the national flag carrier continues to service the country amidst the slowdown of traffic and is leading the recovery of the tourism industry.

PAL The National Flag Carrier has been Privatized

While the economic philosophy of the Philippines is a nationalist one, at the same time it affirms that the private sector is an indispensable engine of development. Specifically, Art. II Sec. 20 of the Philippine Constitution provides:

“Sec. 20. The State recognizes the indispensable role of the private sector, encourages private enterprise, and provides incentives to needed investments.”

Privatization is a powerful catalyst which transformed the national flag carrier into a competitive organization. The introduction of private sector values into a once government owned institution has allowed it to spur forward the agenda and goals of liberalization, albeit at a measured pace. As a national flag carrier, it is run as a commercial business rather than “arms of government” managed by career bureaucrats. The organizational structure is simple and essentially a flat hierarchy. It has adopted a code of corporate governance which seeks transparency its decision making process and pledges to protect and enhance the value of the corporation for all its stakeholders. (Table 3)

The manpower level has been substantially reduced from almost 13,000 in 1998 to 7,161 as of 31 January 2003

Philippine-based	Administrative	1,134
	General	4,131
	Pilots	337
	Cabin Crew	1,303
	Reg. Part Time	10
Foreign-based	Local Hire	230
	Expatriate	<u>21</u>
Total Regular		7,161

PAL has no official responsibilities for providing local employment and is no longer required to maintain unprofitable routes for social or political reasons. The strategy of radical cost cutting is diligently observed. PAL embarked on a painful programme of downsizing which reduced its fleet, network and staff levels by around 45%. PAL is now classified as a middle sized flag carrier with revenues of less than US\$2.0 billions.⁷

The State did not step in to bail out PAL from trouble during the 1997 Asian Crisis. Even after it stopped operations, the government merely created an interagency task force to examine the problems at PAL.⁸ PAL as a commercial enterprise fought to comeback by reorganizing and rehabilitating itself pursuant to a Securities and Exchange Commission approved rehabilitation plan which has been faithfully implemented to this

date. (Table 4) Since the 11 September 2001 crisis, PAL has not received any subsidy or monetary support.

Status of Creditor Claims
(as of December 2002 (in million US Dollars))

Claim Category	Total	Principal Payments				Interest	Total	Balance
	15-Mar-99	Sched	Pre-pmts	Total	%	Pmnts	Pmnts	Aug-02
	A	B	C	D		E	F	G
A. Secured Claims				(B + C)	(D / A)		(D + E)	(A - D)
1. Aircraft Secured								
1.1 Fully Secured	1,408.4	258.3	27.6	285.9	20.3%	334.4	620.3	1,122.5
1.2 Partially Secured	145.6	3.1	0.5	3.6	2.5%	29.6	33.2	142.0
2. Other Secured	200.9	35.3	3.6	38.9	19.4%	49.5	88.4	162.0
B. Retained Operating Lease	11.4	11.4	0.1	11.5	101.1%	1.3	12.8	(0.1)
C. Terminated Finance Lease	0.0			0.0				
D. Interest Rate Swaps	1.3	0.2	0.0	0.2	17.0%	3.2	3.4	1.1
E. Aircraft & Engine Mfgr	0.0			0.0				
F. Unsecured Claims*	298.0	16.7	1.7	18.4	6.2%		18.4	279.6
G. Trade Creditor Claims	60.9	42.2		42.2	69.3%	8.4	50.6	18.7
H. Unimpaired Claims	37.5	37.5		37.5	100%	4.0	41.5	0.0
TOTAL	2,163.9	404.7	33.6	438.2	20.3%	430.2	868.5	1,725.7

* Includes Terminated Operating Lease Claims

PAL is Essential to Promoting the Philippines as a Hub

Many Asian countries are competing to develop their airports into hubs for Asia. The Philippine policy is to -

- Promote the Philippines as an Asia-Pacific hub for air travel and cargo markets for which Philippine cities would be a convenient transfer/transit gateway or transshipment hub.

- Promote the Philippines as a veritable tourist destination.⁹

Without a home carrier, it will be extremely difficult to develop a hub since PAL generates the greatest level of service from its base of operation. As seen from the demise of Sabena and Swiss Air, the status and ambitions of Brussels and Zurich to be hubs were badly dented due to the service cuts and the sale or shutdown of the ancilliary businesses such as maintenance and logistics of their flag carriers.¹⁰

DOES A LARGE COUNTRY OR ECONOMY NEED AN INTERNATIONAL FLAG CARRIER?

Apart from Art. 44 of the Chicago Convention which states that the aims and obligations of the Organization is to “*insure the rights of Contracting States are fully respected and that every contracting State has a fair opportunity to operate international airlines*”, the notion that a large country or economy needs an international flag carrier is something which the world might accept as a self evident truth. A reading of the policy statements issued by the U.S. government and the Australian government is instructive and will readily show that a national flag carrier’s links with their governments have not weakened in a liberalized air transport environment.

CHANGE, CHALLENGE AND COMPETITION

The National Commission to Ensure a Strong Competitive Airline Industry (A report to the President and Congress)

“This nation’s civil aviation system is a vital national resource.

x x x

So why are this Commission’s mandate and effort different? Why have a series of administration and politicians found it critical to spend so much time studying an industry that has been volatile throughout its history?

The answer is simple: The air transportation system has become essential to economic progress for the citizens and businesses of this nation. Without it, our country will be hamstrung in its ability in

participate in an increasingly global community and marketplace. Air transportation makes possible the quick movement of millions of people and billions of dollars worth of goods to markets around the world. We need to be able to compete in those markets, and there is often no practical alternative to air transportation. Similarly, the growth of a competitive domestic economy depends more and more on our ability to move by air. (emphasis added)

US's Policy Objectives

(US International Air Transportation Policy Statement (1995))

"Provide carriers with unrestricted opportunities to develop types of service and systems based on their own assessment of market demand." (emphasis added)

(US Statute No.49 U.S.C. 40101 (a) (15))

"Strengthening the competitive position of air carriers to at least ensure equality with foreign air carriers, including the attainment of the opportunity for air carriers to maintain and increase their profitability in foreign air transportation".

Australian Policy Objectives

(International Air Services Commission Act 1992)

"The maintenance of Australian carriers capable of competing effectively with airlines of foreign countries " (emphasis added)

IMPERFECT COMPETITION IN AN IMPERFECT MARKET

In a competitive market, the possibility of failure must always be present. If a liberalized market is to function properly, every carrier must be subject to the same commercial pressures. This is a situation which does not obtain in the aviation industry since States continue to grant subsidies and States continue to own carriers on a widespread basis. For example, in Europe, the E.U. Commission maintains that it cannot order the state ownership and assistance to airlines to be discontinued in "absolute terms". In short, state aid is lawful and the State checkbook is never closed for the airline industry.

If the aviation market has truly become global then the competitive practices in one country or region will have an impact on the airlines of other countries or regions. Since three fourths of international air transport of passengers is accounted for by carriers from developed countries, and one-quarter by carriers from developing countries,¹¹ small countries have cause for concern on the likelihood of being affected by market distorting practices.

Unlike the U.S.A. and EU, the countries in Asia do not have a legal framework to collectively protect themselves from market distortion. For example, they do not have the machinery to create legislative devices to protect themselves similar to the proposed Regulation of the European Parliament and of the Council concerning protection against subsidization and unfair pricing practices in the supply of airline services from countries not members of the European Community. Neither can the Asian countries match the huge amounts of subsidies.

No international competition law exists. National competition laws are not safe harbors for they are so divergent and their application quite complex that the protective coverage it intends to provide is not effectively achieved nor available at the crucial period to avert irreparable harm.

Each country is therefore left on its own to grapple and respond to the competitive pressures of international business and commerce. In the Philippines, the Constitution provides that “the State shall protect Filipino entrepreneurs against unfair competition and trade practices”.¹²

On this matter, the Philippine Supreme Court ruled, to wit:

“All told, while the Constitution indeed mandates a bias in favor of Filipino goods, services, labor and enterprises, at the same time, it recognizes the need for business exchange with the rest of the world on the bases of equality and reciprocity and limits protection of Filipino enterprises only against foreign competition and trade practices that are unfair. In other words, the Constitution did not intend to pursue an isolationist policy. It did not shut out foreign investments, goods and services in the development of the Philippine economy. While the Constitution does not encourage the unlimited entry of foreign goods, services and investments into the country, it does not prohibit them either. In fact, it allows an exchange on the basis of equality and reciprocity, frowning only on foreign competition that is unfair.”¹³

**HOW CAN WE ACHIEVE SUSTAINABILITY
AND A LEVEL PLAYING FIELD
(without leveling the field)**

Maintain the Bilateral Framework

Given that international aviation is a highly imperfect market, considering further the absence of a legal and political framework similar to the EU in many regions of the globe, the bilateral regulatory framework seems to afford developing countries with the safety net to meaningfully participate without being overrun by the full competitive force which can be unleashed in an imperfect competitive market. At the same time, it can pursue the agenda of liberalization at a measured pace in keeping with its own national objectives. With safety nets in place, national flag carriers of developing countries can pursue a program to compete with other national flag carriers of developed economies which receive subsidies from the State and those national flag carriers which are government owned and/or controlled by developed states.

The critics of the bilateral system, have always argued that it is an unnecessary and burdensome restriction of trade, limiting the availability of air service to the public, and stifling the growth of international trade, travel and tourism.

The airlines in Asia have grown with this system, governing both services within the region and services on intercontinental routes linking Asia with Europe and North America. The pre-determinist nature of most of these agreements have not led to inadequate capacity, poor service levels and low growth.

The experience shows that air agreements which set limits on frequency, capacity and route points do not, in themselves, inhibit growth or prevent the emergence of healthy and efficient airlines, or, for that matter, fierce competition. It is how these agreements are concluded, how they are interpreted and how they are amended to respond to growth, which determines whether competition will flourish, with all its beneficial consequences, or whether air services will stagnate. The ease with which this can be demonstrated results from the fact that not all ASEAN countries have had the same approach to the exchange of traffic rights, and, therefore, contrasts can be drawn between those who have been reasonably open-

handed and imaginative, and those who have adopted a more restrictive approach.

The guiding philosophy of governments in these matters has been in many cases a matter of self-confidence, or rather confidence in the strength and resilience of the national carrier in the face of competition.¹⁴

In the Philippines, the government policy is progressive liberalization with the end goal of promoting fair competition. It supports a calibrated opening of the skies that provides for additional flights to service Philippine-Partner Country traffic through a market-based capacity formula, providing fair and equal opportunity on a level playing field for the Philippine airline industry, promoting new Philippine tourism gateways and the Philippines as an aviation hub.

The Philippines will even go to the extent of institutionalizing a “*trigger mechanism*” in ASAs which can automatically introduce market growth in the route through additional seat capacity beyond the entitlement specified in the ASA, once a specified load factor is reached. In the Medium Term Philippine Development Plan of the National Economic Development Agency (NEDA) it states:

“The country’s accessibility to visitors will be improved by negotiating more or better air services agreements (ASAs) with partner countries to increase the weekly air seat capacity to levels at par with other ASEAN countries such as Thailand, Malaysia and Singapore. The utilization and load factors of existing airlines for Japan, Korea, Taiwan, Hongkong, Malaysia, Singapore, France and the United Kingdom will be reviewed. The Philippines will increase the number of weekly seats available from the air carriers of its major markets for greater accessibility to tourists and investors. At the same time, air carriers of other countries with which the country has bilaterals will be encouraged to maximize the utilization of their entitlement.”

xxx

A ‘trigger mechanism’ will be institutionalized to facilitate the operationalization of additional seat capacity beyond the

entitlements allowed in the pertinent ASA. This will automatically allow an airline already operating at an average load factor of 70 percent to add more seats to immediately respond to increasing demand without the need for renegotiation with other countries.”

Unused Entitlements in ASAs

In the present liberalized air transport environment, the existing inventory of traffic rights granted under ASAs worldwide may be underutilized by the countries. In the case of the Philippines, more than 50% of all capacity entitlements remain unused.

**WEEKLY SEAT CAPACITY ENTITLEMENT AND USAGE
By Region**

Region	Capacity Rights per Region	Capacity Rights on The Route	Airline Operations Philippines	Foreign	Total Seats Offered	Total Unused Rights
AMERICAS	17,500	35,000	8,674	7,557	16,231	18,769
EUROPE	13,200	26,400	0	6,579	6,579	19,821
ASIA/PACIFIC	71,960	143,920	40,016	50,514	90,530	53,390
MIDDLE EAST	15,284	30,568	2,820	8,719	11,539	19,030
GRAND TOTAL						
Weekly Seat Capacity	117,944	235,888	51,510	73,369	124,879	111,010
Annual Seat Capacity	6,133,088	12,266,176	2,678,520	3,815,162	6,493,682	5,772,494

In the case of 58 countries which have entered into open skies agreements with the US, an examination of the level of actual air services in these countries reveals that many countries have not began air service at all to and from the U.S. In some, it has not even begun to introduce any significant degree of competition in the aviation industry.

Fully 36% or 21 countries have no air services to/from the U.S.A at all. Their open skies agreements with the U.S. are purely symbolic.¹⁵

Fully 31% or 18 countries have unilateral operations only, i.e., only U.S. carriers fly to their country, or only the home country airlines fly to the U.S.¹⁶ Such countries face no threat from open skies.

Given all the foregoing, it may be inaccurate to say that liberalization is being hindered by the bilateral framework. On the contrary, unused entitlements is an indication that there are opportunities for the carriers to operate additional international services without the State requesting for greater capacity under existing ASAs.

Privatization of Carriers

In Asia, the majority of the carriers are still government owned and/or controlled organizations. (Table 5)

Breakdown of Carriers in Asia

GOVERNMENT OWNED OR CONTROLLED AIRLINES (GOCA)	PRIVATE OWNED OR CONTROLLED AIRLINES (POCA)
Air China Air India Air New Zealand Air Macau China Southern Airlines China Eastern Airlines Dragon Air Garuda Indonesia Lao Aviation Malaysia Airlines Pakistan Airlines Royal Air Cambodge Royal Brunei Airlines Singapore Airlines Vietnam Airlines	ANA Airways Asiana Airlines Cathay Pacific Airways Eva Air Japan Airlines Korean Air Philippine Airlines, Inc. Qantas Airways

In liberalized and competitive markets, State ownership of carriers in developed economies is not defensible. The Singaporean government which owns 57% of Singapore Airlines is acknowledging this reality by

announcing last year that indeed it may sell its majority stake. But in the meantime, the special relationship which binds the State and SIA continues and this has prompted the CEO of Qantas to correctly observe, to wit:

“Singapore Airlines is a government-owned and –backed carrier that does not have to play by the same rules as other airlines.”¹⁷

Privatization when it occurs will loosen the ties between government and the airlines and allow management the flexibility to make commercial decisions. A different management with different competition instincts will come to the helm.

The Regulator as a Safeguard of a Level Playing Field

The airline industry is in deep financial distress. Last year, in the U.S. airline industry alone, American, United, Delta, Continental, Northwest, and US Airways lost a combined \$10 billion in revenues, after posting a \$6.8 billion loss in 2001. Since 1998 the market capitalization of those majors has fallen from \$44 billion to less than \$4 billion at the end of 2002. United and US Airways have recently gone bankrupt. Recently, UBS Warburg, an investment bank, widened its 2003 loss estimate for the airline industry and predicted all of the surviving major network carriers in the U.S. would go bankrupt within two years unless significant changes are made in their businesses.

This underscores the fragility of the industry and the responsibility of the regulators to create an environment which engenders not only competition but also sustainable profitability for the airlines – small and big.

The carriers cannot be completely left alone. Individual flag carriers' attitudes towards competition and their strategic responses to liberalization are likely to vary significantly depending on their relative efficiency and cost levels as well as the size of their existing home markets and the degree to which they are entrenched in them and can rely on government support. In an unregulated market, this may lead to abuse and anti-competitive behavior. Hence, certain regulation is necessary to guard against such practices.

Regulators around the world will be in the saddle seat to weigh-up conflicting interests and make critical choices. Ultimately, the decision of

the Regulator will reflect their vision of the kind of world they would want to create. Will it be a world where airlines of all sizes and descriptions of different states can co-exist offering the widest options to the consumer or a world dominated by a handful of mega carriers.

Government is a highly imperfect institution, but we must reluctantly concede it is sometimes a necessary companion, particularly to correct market failure in industries essential to the vitality of the nation as a whole.¹⁸ The Regulator's imaginative approach can adroitly move the agenda of liberalization forward and at the same time find a place for the meaningful role which national flag carriers bring to their own countries.

COMMON GROUND; SHARED DESTINY

Article 44 of the Chicago Convention states, as an objective to “*ensure that the rights of Contracting States are fully respected and that every contracting state has a fair opportunity to operate international airlines.*”

The history of aviation shows that the developing world and the developed world share an important element: an overriding motivation in aviation policy to ensure the existence of a national flag carrier. Put differently, no country likes to see its national flag carrier go down.

In the U.S., a country where the airline industry had always remained in the hands of private ownership, the State was compelled to intervene through special legislation to save the industry. In Switzerland, where the aristocracy of the business establishment finds expression in blue chip companies like SwissAir, after its demise, a government-private sector partnership led the creation of “Swiss”, a new national flag carrier of the country. In the case of New Zealand, a leading and vocal proponent of free trade and accelerated liberalization in international air transport, the government stepped in and renationalized Air New Zealand to maintain a national flag carrier. In the case of a developing country like Malaysia, the government pursued a reverse privatization of Malaysia Airlines to avert the collapse and disappearance of a national flag carrier.

Each country has its own compelling reason for supporting its national flag carrier(s). Principally economic but also blended with a lot of non-economic factors which seems to have been underestimated in this era of globalization where almost all explanations are reduced to economic efficiency and

productivity. The paradox of competition may however lie in the creation of an irrational desire in States to compete regardless of the high price it commands in terms of resources.

Whether the national flag carrier of a State should continue to exist, is a complex issue which cannot be determined solely on the basis of economic analysis or abstract models of transportation systems. Any realistic appraisal or policy must take the political dimension into account as well. So often, policy is not determined by the “*objective*” economics of the situation, but by political perceptions, accurate or otherwise and by a multitude of other non-economic considerations. For the foreseeable future, the international airline industry is unlikely to become just a matter of commerce and business. It will remain highly political and involve complicated diplomatic negotiations.

-o0o-

REFERENCES

-
- ¹ Art. XII Sec. 11 of the Philippine Constitution
- ² Convention on International Civil Aviation, 7 Dec. 1944, 15 UNTS 295, ICAO Doc. 7300/6 (hereinafter Chicago Convention)
- ³ Philippines: World Leader in Migrant Labor by Dennis Aramjo, *Philippine Daily Inquirer*, March 14-15, 2003
- ⁴ Air Transport Services: The Positive Agenda for Developing Countries, Business World United Nations Conference on Trade and Development Paper (1999)
- ⁵ World Tourism Organization (1996) *Aviation and Tourism Policies: Balancing the Benefits*
- ⁶ *Aviation Analyst Asia Pacific*, October 2002,
- ⁷ Flag Bearers by Emre Serpen and K.O' Toole, *Airline Business*, October 2002
- ⁸ Administrative Order No. 16, 1998
- ⁹ Civil Aviation Consultative Council Centennial Aviation Conference 1998 (Resolution No 001-98 p. 3)
- ¹⁰ Out of the Ashes by Colin Baker, *Airline Business*, March 2002
- ¹¹ United Nations Conference on Trade and Development Paper 1999
- ¹² Art. XII, Sec. 1 of the Philippine Constitution
- ¹³ *Tanada v. Angara*, Philippine Supreme Court Report Annotated Vol. 272 (1997)
- ¹⁴ The Politics and Practicalities of Air Transport Liberalization in the ASEAN Region by Richard Stirland, Director General, Association of Asia Pacific Airlines
- ¹⁵ Bahrain, Benin, Brunei Darussalam, Burkina Faso, Cape Verde, Luxembourg, Malta, Morocco, Namibia, Netherlands Antilles, Norway, Oman, Qatar, Rwanda, Senegal, Slovakia, Sri Lanka, Tanzania, United Arab Emirates, Uganda and Uzbekistan
- ¹⁶ Austria, Aruba, Czech Republic, Denmark, Dominican Republic, Finland, Gambia, Ghana, Guatemala, Iceland, Jordan, Malaysia, Nicaragua, Nigeria, Pakistan, Poland, Romania and Sweden.
- ¹⁷ Against the Wind, *Time* March 2003
- ¹⁸ Dysfunctional Economics and the Airline Industry by Paul Stephen Dempsey, *Annals of Air and Space Law*, Vol. XX-1995 Part I