STUDY ON INDUSTRIAL SUB-SECTOR DEVELOPMENT IN THE REPUBLIC OF THE PHILIPPINES

FIRST YEAR FINAL REPORT

April 1991

Japan International Cooperation Agency (JICA)

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PREFACE

In response to a request from the Government of Republic of the Philippines, the Japanese Government decided to conduct a master plan for the study on Industrial Sub-Sector Development in the Republic of the Philippines and entrusted the study to the Japan International Cooperation Agency (JICA).

JICA sent to the Philippines a study team, jointly organized by Japan External Trade Organization and Unico International Corporation, headed by Mr. Tamaichi Matsumoto, three times between March to November 1991.

The team held discussions with the officials concerned of the Government of the Philippines, and conducted field surveys. After the team returned to Japan, further studies were made and the present report was prepared.

I hope that this report will contribute to the promotion of the project and to the enhancement of friendly relations between our two countries.

I wish to express my sincere appreciation to the officials concerned of the Government of the Republic of the Philippines for their close cooperation extended to the team.

April, 1991

Kensuke Yanagiya

Kensuke Yanagiya
President
Japan International Cooperation Agency

CONTENTS

ANNEX

LIST OF TABLES & FIGURES

Tables

Figures

Abbreviations

AHAM	Association of Home Appliance Manufacturers
AI	Artificial Intelligence
ALMS	Asset and Liability Management System
AOTS	Association for Overseas Technical Scholarship
ASEAN	Association of Southeast Asian Nations
ASOCIO	Asian-Oceanian Computing Industry Organization
AUV	Asian Utility Vehicle
BAP	Banker's Association of the Philippines
BETP	Bureau of Export Trade Promotion
BOI	Board of Investments
BPMM	Buy Philippine Made Movement
BPS	Bureau of Product Standard
BSMBD	Bureau of Small and Medium Business Development
CAD/CAM/CAE	Computer Aided Design/Manufacturing/Engineering
CAI	Computer Aided Instruction
CASE	Computer Aided Software Engineering
CB	Central Bank of the Philippines
CBU	Completely Built-up
CCTV	Closed Circuit Television Camera
CD	Cash Dispenser
CD-ROM	Compact Disc Read Only Memory
CDP	Car Development Program
CEPMA	Consumer Electronic Products Manufacturers Association
CFIP	Chamber of Furniture Industries of the Philippines
CHAMP	Cooking and Heating Appliances Manufacturers of the Philippines
CIB	Credit Information Bureau
CIM	Computer Integrated Manufacturing
CISC	Computer Instruction Set Computer
CITC	Cottage Industry Technology Center
CITEM	Center for International Trade Expositions & Missions
CKD	Completely Knocked Down
CNC	Computerized Numerical Control
CPU	Central Processing Unit
CSF	Common Service Facility
CVDP	Commercial Vehicle Development Program
DBP	Development Bank of the Philippines
DECFI	Design and Engineering Center Foundation, Inc.
DOF	Department of Finance
DOST	Department of Science and Technology
DTI	Department of Trade and Industry
DTP	Desk-Top Publishing
ECM	Electret Condenser Microphone
EDI	Electronic Data Interchange
EDM	Electric Discharge Machine
EDP	Electronic Data Processing

EZMP	Export Industry and Modernization Program
FA	Factory Automation
FAME	Furnishings and Apparel Manufacturers Exchange
FCDU	Foreign Currency Deposit Unit
FDD	Floppy Disk Drive
FMS	Flexible Manufacturing System
FPRDI	Forest Products Research and Development Institute
FTZ	Free Trade Zone
GSP	Generalized System of Preferences
GTZ	Deutsche Gesellshaft fuer Technische Zusammenarbeit
HDD	Hard Disk Drive
HSF	Hanns Seidel Foundation
IDAFJ	International Development Association of the Furniture Industry of Japan
IGLF	Industrial Guarantee and Loan Fund
IMF	International Monetary Fund
IPP	Investment Priorities Plan
IRTC	Integrated Research and Training Center
ISDN	Integrated Services Digital Network
ISO	International Standard Organization
ISTA	International Special Tooling Association
ITAP	Information Technology Association of the Philippines
JEFMA	Japan Export Furniture Manufacturers' Association
JETRO	Japan External Trade Organization
JICA	Japan International Cooperation Agency
JIPDEC	Japan Information Processing Development Center
JIS	Japanese Industrial Standard
JISA	Japan Information Service Industry Association
JV	Joint Venture
LAMPS	Lamps & Allied Electrical Products Manufacturers of the Philippines
LAN	Local Area Network
LCV	Light Commercial Vehicle
MC	Machining Center
MDP	Motorcycle Development Program
MDPPA	Motorcycle Development Program Participants Association Incorporation
MEP	Memorandum of Economic Policy
MEPZ	Mactan Export Processing Zone
MIAP	Metalworking Industries Association of the Philippines
MICR	Magnetic Ink Character Reader
MIRDC	Metals Industry Research and Development Center
MIS	Management Information System
MRR	Manila Reference Rate
MS-DOS	Microsoft Disc Operating System
NC	Numerical Control
NCC	National Computer Center
NACIDA	National Cottage Industries Development Authority
NCR	National Capital Region
NCU	Network Control Unit
NEDA	National Economic and Development Authority

NEP	New Economic Policy
NIES	Newly Industrializing Economies
NITP	National Information Technology Plan
NMYC	National Manpower and Youth Council
OBU	Offshore Banking Unit
OCR	Optical Character Reader
OEM	Original Equipment Manufacturing
OMR	Optical Mark Reader
OS	Operating System
PADEC	Philippine Association of Data Entry Corporations
PATE	Philippine Association for Technological Education
PC	Personal Computer
PCCI	Philippine Chamber of Commerce and Industry
PCMP	Progressive Car Manufacturing Program
PCS	Philippine Computer Society
PDCP	Private Development Corporation of the Philippines
PDDCP	Product Development and Design Center of the Philippines
PDIC	Philippine Deposit Insurance Corporation
PEF	Philippine Exporters Foundation
PEFMA	Philippine Electric Fan Manufacturers Association
PEPCEP	Progressive Export Program for Consumer Electronic Products
PFS	Philippine Foundry Society
PHILGUARANTEE	Philippine Export and Foreign Loan Guarantee Corporation
PITC	Philippine International Trading Corporation
PLDT	Philippine Long Distance Telephone Company
PMAP	Personnel Management Association of the Philippines
PMMP	Progressive Motorcycle Manufacturing Program
PNB	Philippine National Bank
PNS	Philippine National Standard
POS	Point of Sales
PSA	Philippine Software Association
PSA	Philippine Steelworkers Association
PT&T	Philippine Telegraph and Telephone Corporation
PTMP	Progressive Truck Manufacturing Program
PTTC	Philippine Trade Training Center
QA	Quality Assurance
R&D	Research and Development
RCS	Remote Computing Service
RISC	Reduced Instruction Set Computer
RJE	Remote Job Entry
SA	System Analyst
SE	System Engineer
SEASF	Southeast Asian Science Foundation, Incorporated
SEC	Securities and Exchange Commission
SEIFI	Semiconductor Electronic Industry Foundation Incorporation
SERDEF	Small Enterprises Research and Development Foundation
SIS	Strategic Information System
SKD	Semi-completely Knocked Down

STCC	Science and Technology Coordination Council
TB	Treasury Bill
TCP/IP	Transaction Control Processing/Interface Protocol
TLRC	Technology and Livelihood Resource Center
TPRC	Technical Planning and Review Committee
TSS	Time Sharing System
TST-SELA	Tulong Sa Tao-Self Employment Loan Assistance
TUFP	Technology Utilization Financing Program
ULFP	Urban Livelihood Financing Program
UP	University of the Philippines
USAID	US Agency for International Development
VAD	Value Added Distributor
VAN	Value Added Network
VAR	Value Added Reseller
VC	Venture Capital

I. Introduction

I. Introduction

This is the final report for the first year of surveys conducted under the Industrial Sub-sector Development Program in the Republic of the Philippines.

The surveys were begun in March 1990 on the basis of the Scope of the Study signed between the Department of Trade and Industry (DTI) of the Philippine government and the Japan International Cooperation Agency (JICA) on October 6, 1989. The final report was completed in April 1991.

1. Survey Background

Economic reconstruction, and particularly the repayment of external debt amounting to $30 billion, alleviation of poverty, democratization of economy and society, enhancement of employment opportunities, and establishment of equality and social justice were some of the issues facing the Aquino administration, inaugurated in February 1986.

Accordingly, the administration drew up a medium-term (1987-1992) development plan and grappled with the restoration of social order, improvement of efficiency in the government sector, economic development in the provinces, agrarian reform, promotion of local and foreign investment, and promotion of exports centering on non-traditional products.

Economic recovery, increased foreign investment, and a multilateral assistance initiative with the reduction of debts as its primary object materialized during the period. However, a rebellion of part of the AFP occurred in December 1989, and natural and man-made disasters such as droughts, earthquakes, typhoons, power stoppages and the deterioration of public peace and order broke out in 1990. The Gulf crisis, which started in August, brought about higher oil product prices and less remittances from Filipinos working in the Middle East. Thus, the economic performance of the country worsened quickly.

In the future as well, industrial development and export promotion will be indispensable for the management of the country's economy, though it is hard to steer because of many restraints.

2. Survey Objectives

The surveys aim at studying and analyzing sub-sectors and products regarded as promising for export in the future and drawing up a comprehensive export promotion program. Also, as a means of promoting joint ventures and technological tie-ups between Japan and the Philippines, information about firms desiring to engage investment and joint ventures should be prepared.

It should also be noted that the implementation of these surveys should facilitate the transfer to the Philippine side of fundamental knowledge and know-how on industries, products, and the improvement of marketing methods.

3. Industries to be Surveyed

The following sub-sectors were surveyed in the first year:

Metal engineering (die making for metals)

Wooden furniture
Computer software and services

4. Survey Items

The surveys were implemented in line with the following items provided in the Scope of the Study.

(1) Overview of the selected sub-sectors and products

1) Production items in each sub-sector
2) Volume and value of production and quality of products
3) Volume and value of exported and imported products and their quality
4) Number of firms classified by size and number of employees
5) Profile of leading firms

(2) Overview of the industrial development policies and related measures of the government as well as the infrastructure for nurturing the selected sub-sectors and products

1) Administrative and policymaking organs
2) Sector development
3) Export promotion
4) Promotion of investment and technological tie-ups
5) Tax system
6) Financial system

(3) Overview of current problem areas in the selected sub-sectors and products

1) Manufacturing processes
2) Technological level (equipment and technology)
3) Plant management and quality control
4) Production development and design
5) Management of firms (labor-management relations, training of employees, financial management, etc.)
6) Raw material purchases and relations with supporting industries (subcontractors and parts suppliers)
7) Cost analysis
8) Marketing strategies

(4) Surveys of markets and policies classified by sub-sectors and products

1) Production, exports and imports by and of the specified sub-sectors and products
2) Competitiveness of the specified sub-sectors and products with competing countries
3) Marketability in importing countries of the sub-sectors and products

(5) Formulation of a master plan for nurturing the selected sub-sectors and products

1) Improvement of policies and systems
2) Improvement of technologies
3) Improvement of product and design development systems
4) Improvement of quality and reduction of cost

5) Improvement of management and training of employees
6) Creation of networks for sales and marketing
7) Improvement of financial and taxation systems

(6) Provision of information for the promotion of investment and technological tie-ups in the selected sub-sectors and products

1) Compilation of a list of Japanese firms having interest in investment
2) Compilation of a list of Philippine firms desiring joint ventures or technological tie-ups
3) Collection of information about the above-mentioned firms

5. Survey Methodology

On the basis of preparatory and advance surveys conducted by JICA, the Study Team adopted a deductive approach by which hypotheses of planned scenarios which would be eventually proposed were set up in advance and verified through field surveys, etc.

Work in concrete terms was as follows:

(1) Advance preparations

1) Collection and analysis of existing materials and statistics
2) Drawing up of detailed plans for field surveys and domestic work
3) Preparation of an inception report and survey flowchart
4) Formulation of the questionnaire

(2) Field surveys

1) Explanation of the inception report and consultations on planned surveys
2) Gathering of information through interviews and discussions with related organs
3) Field surveys at the related firms or factories
4) Formulation and filing of the progress report
5) Filing of an interim report, discussions about the program and supplementary surveys

(3) Third country surveys

Surveys of third countries were conducted through the study of written materials and surveys commissioned through JETRO overseas offices.

(4) Domestic work

1) Compilation and analysis of field surveys
2) Compilation and analysis of third country surveys
3) Interviews, field surveys, questionnaires for related domestic firms and analysis of the results
4) Overview and study of problems in concrete terms
5) Formulation and study of the interim report
6) Preparation of a comprehensive program and compilation of the final report

6. Schedule of Surveys

First field survey March 15 - March 29, 1990

Second field survey	June 4 - August 17, 1990
Interim consultations and supplementary surveys	November 11 - November 22, 1990
Draft final consultations	March 11 - March 19, 1991
Domestic questionnaires	June - August 1990
Third country surveys	July - September 1990

In-depth interviews were used for the field surveys. A total of 214 such interviews were made and a total of 373 questionnaires collected. A breakdown by sub-sectors is shown in Table I-1. Geographical areas covered by the field surveys in the Philippines are shown in Table I-2.

Table I-1: Details of Field Survey

Sub-sector	In-depth 1st	Interviews[a] 2nd	3rd	Questionnaires Collected	Remarks
Metal engineering	7	58	8	74[b]	Complete count
Wooden furniture	10	54	5	226[c]	Sample survey[e]
Computer software	10	57	5	73[d]	Complete count

Notes: (a) In-depth interviews were conducted with private companies, a small number of institutions, universities and other organizations.
(b) A total of 120 questionnaires were distributed.
(c) A total of 350 questionnaires were distributed.
(d) A total of 140 questionnaires were distributed.
(e) The sample survey was conducted mainly on CFIP (Chamber of Furniture Industry of the Philippines) registered firms which were beginning to venture into exports.

Table I-2: Geographical Areas Covered by Field Survey

Sub-sector	Areas Covered
Metal engineering	Metro Manila, Laguna, Cebu
Wooden furniture	Metro Manila, Pampanga/Angeles, Cebu, Davao
Computer software	Metro Manila

For the efficient implementation of the field survey, the following local consultants were engaged to distribute questionnaires, assist in their completion, collect and tally them.

Metal engineering / Small Enterprises Research and Development Foundation of the Philippines
Wooden Furniture / Chamber of Furniture Industry of the Philippines
Computer Software and Services / Philippine Computer Society

Table I-3: Details of Questionnaire Survey in Japan

Sub-sector	Companies Covered	No. of Companies	Study Items
Metal engineering	Manufacturers	249	• Business relations with related industries and firms in the Philippines and Japan • Appraisal of Philippine-made dies and molds and expectations for them
Wooden Furniture	Manufacturers	104	• Problems with the products of Japanese manufacturers and the possibility of overseas investments and technological tie-ups • Possibilities for interchanges between the industries of Japan and the Philippines
Computer Software	Software Houses	296	• Degree of interest in business with Asian countries including the Philippines

Table I-4: Countries Covered by Survey of Third Countries

Sub-sector	Export Markets	Competing Countries
Metal Engineering	-	Singapore, Thailand
Wooden Furniture	U.S.	Indonesia
Computer Software	U.S., Canada	Singapore, Thailand

This survey was implemented by a joint venture formed between JETRO (Japan External Trade Organization) and Unico International Corporation. The study team was composed of the following members.

Team leader/General Affairs	Mr. Tamaichi MATSUMOTO	JETRO
Sub-leader/Export and investment promotion plan	Mr. Nobuo KOBAYASHI	"
Export industry promotion plan (metal engineering)	Mr. Masayuki SWEDA	"
" (wooden furniture)	Ms. Chieko OHGAKI	"
" (computer software)	Mr. Atsushi SUZUKI	"
Market analysis (investment promotion)	Mr. Yutaka MIYAHARA	"
Market analysis (export promotion)	Mr. Jun TSUNEKAWA	"
Sub-leader/Industrial development plan	Mr. Tetsuo INOOKA	Unico International Corp.
Industrial association development	Mr. Yoshio SATO	"
Finance and taxation system	Mr. Yasunaga TAKACHIHO	"
Business administration (metal engineering)	Mr. Takeshi INOUE	"
Production technology (")	Mr. Makoto NAGATOMO	"
" (")	Mr. Shohachi KURIHARA	"
Business administration (wooden furniture)	Mr. Hiroshi HASEGAWA	"
Production technology (")	Mr. Yoshio WATANABE	"
Business administration (computer software)	Mr. Yoshinari YAMAMOTO	"
Production technology (")	Mr. Tatsumi ARAGAKI	"

II. Policy Review and Tasks

II. Policy Review and Tasks

The state of the Philippines' socio economy and the direction of its economic policies fluctuate considerably. Various policies have been announced recently in connection with the structural adjustments of the economy. The policy review contained below does not refer to developments occurring after the time of writing of the report, nor developments, the impact of which were uncertain even though they were taking shape at the time of writing. Those new policy directions and subsequent changes in policy formulation will be reflected in the context of second year Report. It may be noted that the intended process for the second year study consists of providing an avenue for discussion based on the review outlined below between the Study Team and those who play a central role in the policy area.

1. Overview of the Economy

(1) Profile of the Philippines

The Philippines consists of a total of more than 7,000 islands, including the two large islands of Luzon and Mindanao. The socio-economic spheres may be devided into three major areas: Luzon, Mindanao and the Visayas- the islands scattered between Luzon and Mindanao. As shown in Figure II-1-1, for administrative purposes the country is divided into the National Capital Region and 12 other regions. These 12 regions are divided further into 71 smaller administrative units which are called provinces.

Social and economic indicators which provide a comparison between the Philippines and Indonesia, Thailand, Republic of Korea and Japan are shown in Table II-1-1. The Philippines' GDP is lower than that of Thailand which has nearly the same population, and is the lowest of all ASEAN members. A feature of the Philippines' GDP is that, a large proportion of GDP is derived from the agricultural and forestry, fisheries, and wholesale and retail sectors. As for the value of its exports and imports, it is smaller than those of its fellow ASEAN members Thailand and Indonesia.

(2) Economic Growth and the Industrial Structure

The growth of the Philippine economy began to slow down rapidly in the 1980s. In 1983 GDP remained at 99,920 million pesos (in 1972 constant prices. The same applies hereon.) which was equal to an increase of less than 1% over that recorded for the previous year. There was minus growth in 1984 and 1985, with the level of GDP for 1985 of 89,803 million pesos having fallen to the 1979 level (Table II-1-2). However, with the establishment of the Aquino administration in 1986 the GDP tended to recover and recorded 107,143 million pesos in 1989 (provisional), an increase of 5.6% over that recorded for the previous year. Investment from abroad also started to recover showing an annual increase (Table II-1-4). However, political instability, shown by the frequent and repeated occurrence of coup attempt, and latent social instability caused through the failure of the country's economic growth to show up in the lives of people have resulted in insufficient growth in investment. The reality of the situation is that with a continued annual increase in population of 2.5% the real GDP per capita has been insignificant over the past 13 years. Although a small increase in GDP per capita was recorded up to 1,949 pesos in 1982 compared to 1,679 pesos in 1976, by 1989 (provisional) it had dropped back to 1,783. This was on a par with that recorded in 1976.

As is shown in Table II-1-3 which shows the component ratios of GDP by sector for 1989 (provisional), the agricultural sector accounted for 27% of GDP, the industrial sector 33%, and the service industries sector 40%. The percentage of GDP derived from the service industries sector has stood at somewhere around 40% since the 1950s, with no change at any significant degree. Whereas the percentage of GDP derived from the industrial sector increased annually up until the 1980s, that of the agricultural sector recorded a relative decrease. However, the slump in the industrial sector which has been experienced since the 1980s has resulted in a relative decline in the proportion of GDP from that sector and an increase in that of percentage derived from the agricultural sector.

Figures on the numbers of employees by industry not only show that employment in the agricultural sector still accounts for nearly 50% of the whole, but this fact also indicates inadequate employment capacity by the industrial sector, and the presence of a latent unemployment in rural areas. Accordingly, as is pointed out in the 1987-1992 Medium-Term Philippine Development Plan, as shown in the later section, the continued future expansion of domestic production activities through an expansion in the domestic market as a result of the employment of the work force resident in the rural sector in production activities and the resultant increase in their purchasing power will prove indispensable in the formation of a base for the modernization of industry which can be expected as a result of such expansion.

(3) International Balance of Payments and External Trades

The economic collapse encountered during the period between the beginning of the middle of the 1980s is attributed to the development of inefficient industries enforced since 1970s with protective measures which have been heavily dependent on imported machinery, materials and parts. It led to a chronic excess of imports over exports and the deterioration of the international balance of payments, while stagnating the domestic production because of difficulties in importing the required raw materials and parts under the stringent conditions of foreign exchange.

The recent state of the international balance of payments and the external debts is shown in Table II-1-4. The policy of economic expansion previously adopted was relied on external debts such as the financing by IMF, etc. since the 1970s. As a result, the external debts increased out of proportion to the scale of the domestic economic activities. Entering the 1980s, the Philippines' economy and the fall of the prices of the primary products, and with the deadlock of the negotiation to defer the external debts in 1983, the country was forced to implement a tight economic policy. Also, the switch to the floating exchange rate in 1984 further intensified the economic crises.

The international balance of payments of the Philippines has continued, since the first oil crisis, a pattern of covering the trade deficits and the invisible trade deficits with inflow of the loan and capital transfer. Up to 1983, the deficit of the overall balance of payments continued to increase year after year amounting to 2 billion US dollars in 1983, with the trade deficit of 2.5 billion US dollars. Since 1984, the trade deficit decreased by the control of imports, resulting in a surplus of the overall balance of payments. Since 1987, however, imports started to increase again with the recovery of business, and the overall balance of payments have decreased.

The mainstream of the Philippines' exports has changed from such traditional primary products as sugar, coconut, copper concentrates, etc. to non-traditional manufactured products such as semiconductors and other electronic parts, garments, etc. In 1986, the export of electronic parts and garments accounted for 25% and 21% of the total export amount respectively. These, however, are mostly exports of consignment-based manufactures which are based on the raw materials and parts supplied from abroad by the foreign buyers of the final products. Among other exports, phosphoric acid and phosphate fertilizers, food, toys, handicrafts, etc. follow.

In imports, raw materials and intermediates account for 50% of the total imports. Of this, the consignment-based imports of raw materials and intermediates account for a majority.

(4) Centralization of the Economic Activities in Metro Manila

More than 50% of the gross value added in the manufacturing sector and also more than 50% of the employment are concentrated in the Metro Manila region. Such concentration phenomena has been derived from the economic superiority of the location of the region, consisting of such factors as the presence of an international port, relatively well established infrastructure, easy access to the central organizations and the biggest domestic market supported by the residents accounting for 10% or more of the total population. The government has currently been pursuing the regional development focusing on the promotion of regional industries utilizing local resources with the development of export processing zones or industrial estates in the regions and also with the provision of BOI's incentives to the industrial investments in the regions. In recent years, the industrial investments in the Cebu region show a substantial increase, followed by the regions of Cagayan de Oro and Illigan in the North Mindanao and Davao in the South Mindanao where the industrial investments have gradual increases. In general, however, the regional markets are situated in limited conditions. Even for the firms located in the regions, their main market is limited to the Manila area. Thus, the location of operation in the regions has an economic disadvantage.

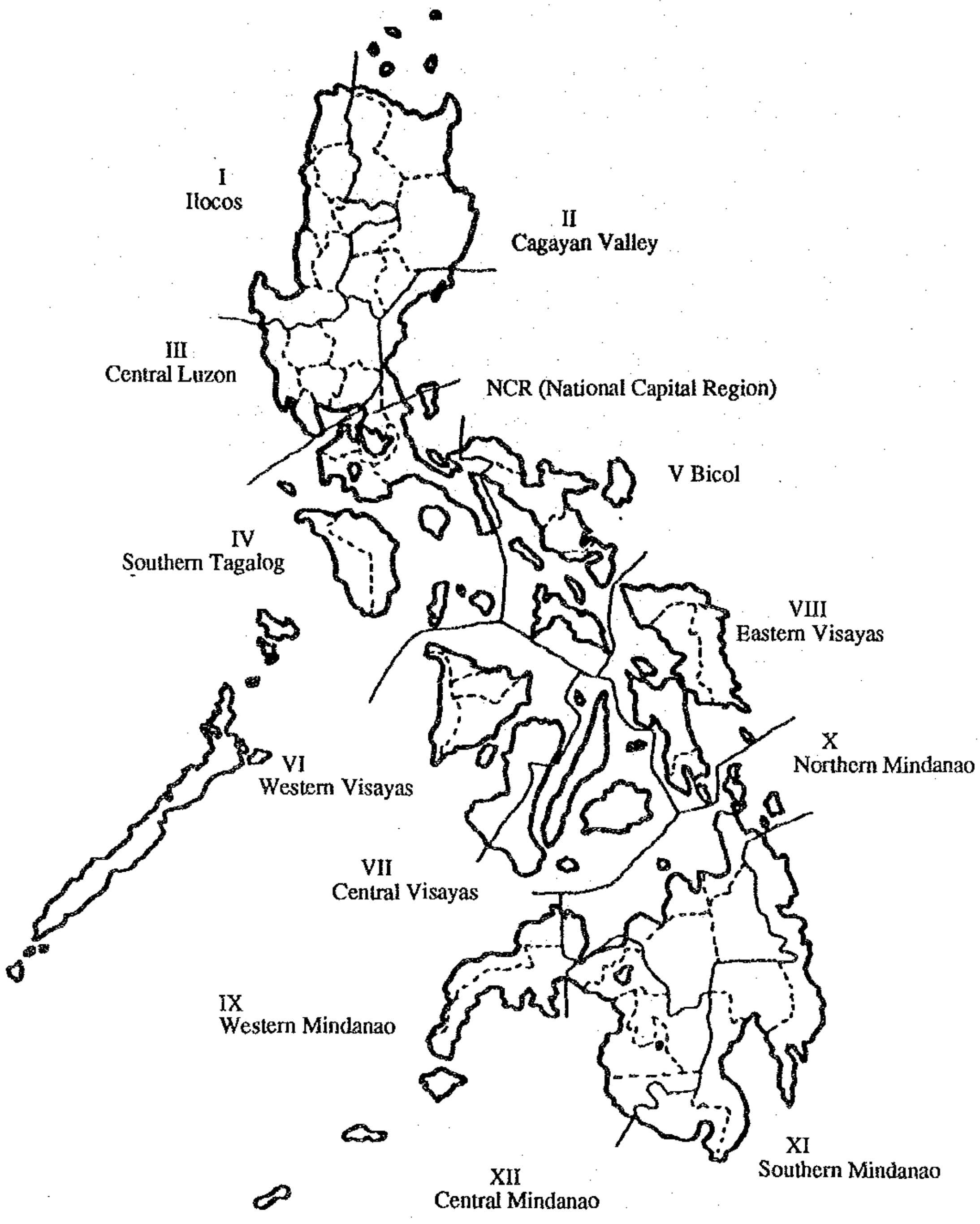


Fig.II-1-1: Map of The Philippines

Table II-1-1: Social and Economic Indicators, The Philippines

	Indicators	Unit	Philippines	Reference			
				Indonesia	Thailand	R. Korea	Japan
1)	Land Area (a)	1,000 sq.km	300.0	1,904.6	513.1	99.0	377.8
2)	Population in 1989 (b) *1	million	60.10	179.14	55.45	42.38	123.12
	Ratio of Urban Population to Total Population *2	%	5.7	8.5	10.1	40.4	20.6
	Population Density (b / a)	persons / sq.km	200	94	108	428	326
3)	GDP (c) *3	billion US$	31.0	77.3	41.8	100.6	1,970.6
	Population in 1986 (d) *1	million	56.00	166.94	52.65	41.18	121.49
	Per Capita GDP (c / d)	US$	554	463	794	2,443	16,220
	Percent of GDP by Sector:						
	- Agriculture, Fishery and Forestry	%	26	26	17	12	3
	- Mining and Manufacturing	%	28	26	25	34	33
	- Construction	%	4	5	5	8	8
	- Wholesale and Retail	%	19	17	23	13	13
	- Transport and Communication	%	6	7	9	8	6
	- Others	%	17	19	21	24	37
4)	Foreign Trade *4						
	- Exports	billion US$	7.77	19.47	20.06	62.33	273.93
	- Imports	billion US$	11.17	13.25	25.09	61.30	209.72

Notes: *1 Estimates of mid-year population
*2 Urban population means the population in cities with population more than one million, in 1988.
*3 In 1986
*4 In 1989 except for Indonesia (in 1988)

Sources: UN Monthly Statistical Bulletin
IMF-IFS

Table II-1-2: Gross Domestic Product by Sector, The Philippines

(Unit: in 1972 million pesos)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	*1 1989
1. Agriculture, Fishery and Forestry	19,671	20,646	21,620	22,595	23,732	24,608	25,378	24,845	25,409	26,252	27,110	26,834	27,793	28,986
2. Industrial Sector	24,904	27,554	29,598	32,343	33,471	34,963	35,714	35,955	32,282	29,000	28,396	30,498	33,235	35,533
1) Mining & Quarrying	1,491	1,742	1,809	2,134	2,236	2,175	2,016	1,966	1,755	1,768	1,574	1,547	1,615	1,563
2) Manufacturing	17,481	19,532	21,108	22,239	23,175	23,959	24,535	25,108	23,319	21,541	21,717	23,076	25,281	26,886
3) Construction	5,254	5,568	5,913	7,121	7,139	7,830	8,079	7,689	5,866	4,258	3,382	3,967	4,344	4,947
4) Electricity, Gas and Water	678	712	768	849	921	999	1,084	1,192	1,342	1,433	1,723	1,908	1,995	2,137
3. Service Sector	28,387	29,790	31,579	33,408	35,503	36,636	37,907	39,120	36,236	34,551	35,674	38,039	40,422	42,624
1) Transportation	3,875	4,235	4,501	4,613	4,827	5,040	5,165	5,266	5,032	4,953	5,105	5,251	5,487	5,761
2) Trade	14,999	15,838	16,861	18,085	19,345	19,695	13,103	13,930	14,073	14,066	14,337	15,153	15,998	16,795
3) Finance & Housing	9,513	9,717	10,217	10,710	11,331	11,901	7,252	7,578	5,134	3,985	4,831	5,832	6,250	6,843
4) Services	-	-	-	-	-	-	12,387	12,346	11,997	11,547	11,401	11,803	12,687	13,225
4. Total Gross Output (1+2+3) (Gross Domestic Product)	72,962	77,990	82,797	88,346	92,706	96,207	98,999	99,920	93,927	89,803	91,180	95,371	101,450	107,143
Per Capita GDP (pesos)	1,679	1,746	1,804	1,876	1,919	1,943	1,949	1,920	1,761	1,643	1,628	1,663	1,727	1,783
Population (thousand)	43,456	44,673	45,888	47,104	48,317	49,526	50,783	52,055	53,351	54,668	56,004	57,348	58,727	60,100

Note: *1 Preliminary
Sources: National Accounts Staff, Statistical Coordination Office, NEDA
Philippine Statistical Yearbook 1989, NEDA
Economic Indicators, June 1990, NEDA
UN Monthly Statistical Bulletin, Nov. 1990

Table II-1-3: Share of GDP by Industrial Sector, The Philippines

(Unit: %)

Particulars	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
1. Agriculture, Fishery and Forestry	27.0	26.5	26.1	25.6	25.6	25.6	25.6	24.9	27.1	29.2	29.7	28.1	27.4	27.0
2. Industrial Sector	34.1	35.3	35.7	36.6	36.1	36.3	36.1	36.0	34.4	32.3	31.1	32.0	32.8	33.2
1) Mining & Quarrying	2.0	2.2	2.2	2.4	2.4	2.3	2.0	2.0	1.9	2.0	1.7	1.6	1.6	1.5
2) Manufacturing	24.0	25.0	25.5	25.2	25.0	24.9	24.8	25.1	24.8	24.0	23.8	24.2	24.9	25.1
3) Construction	7.2	7.1	7.1	8.1	7.7	8.1	8.2	7.7	6.2	4.7	3.7	4.2	4.3	4.6
4) Electricity, Gas and Water	0.9	0.9	0.9	1.0	1.0	1.0	1.1	1.2	1.4	1.6	1.9	2.0	2.0	2.0
3. Service Sector	38.9	38.2	38.1	37.8	38.3	38.1	38.3	39.2	38.6	38.5	39.1	39.9	39.8	39.8
1) Transportation	5.3	5.4	5.4	5.2	5.2	5.2	5.2	5.3	5.4	5.5	5.6	5.5	5.4	5.4
2) Trade	20.6	20.3	20.4	20.5	20.9	13.2	13.9	15.0	15.7	15.7	15.9	15.8	15.7	
3) Finance & Housing	13.0	12.5	12.3	12.1	12.2	12.4	7.3	7.6	5.5	4.4	5.3	6.1	6.1	6.4
4) Services	-	-	-	-	-	-	12.5	12.4	12.8	12.9	12.5	12.4	12.5	12.3
4. Total Gross Output (1+2+3) (Gross Domestic Product)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Table II-1-2

Table II-1-4: Balance of Payment and Foreign Exchange Reserves, The Philippines

(Unit: million US$)

Particulars	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988*2
1. Trade Balance [1) - 2)]	-1,060	-764	-1,307	-1,541	-1,939	-2,224	-2,646	-2,482	-679	-482	-202	-1,017	-1,085
1) Exports of Goods	2,574	3,151	3,425	4,601	5,788	5,722	5,021	5,005	5,391	4,629	4,842	5,720	7,074
2) Imports of Goods	3,634	3,915	4,732	6,142	7,727	7,946	7,667	7,487	6,070	5,111	5,044	6,737	8,159
2. Services (Net)	-259	-248	-107	-311	-399	-309	-1,040	-730	-855	26	783	0	-77
1) Inflow	871	1,085	1,484	1,655	2,222	2,896	2,983	3,127	2,619	3,288	3,791	3,454	3,606
2) Outflow	1,130	1,333	1,591	1,966	2,621	3,205	4,023	3,857	3,474	3,262	3,008	3,454	3,683
3. Transfer (Net)	269	260	312	355	434	472	486	472	236	379	441	573	789
1) Inflow	280	273	322	369	451	485	498	483	237	388	445	575	791
2) Outflow	11	13	10	14	17	13	12	11	1	9	4	2	2
4. Current Account Balance (1+2+3)	-1,050	-752	-1,102	-1,497	-1,904	-2,061	-3,200	-2,740	-1,298	-77	1,022	-444	-373
5. Long-term Loans (Net)	1,040	662	891	1,151	1,032	1,332	1,548	1,392	539	2,787	815	159	-329
1) Inflow	1,407	1,242	1,850	2,110	1,579	2,072	2,533	2,336	1,308	3,962	2,545	2,598	2,372
2) Outflow	367	580	959	959	547	740	985	944	769	1,175	1,730	2,439	2,701
6. Direct Investments (Net)	144	216	100	20	-102	175	17	112	-7	-9	114	326	986
1) Inflow	185	236	134	146	119	248	194	255	121	124	186	439	1,077
2) Outflow	41	20	34	126	221	73	177	143	128	133	72	113	91
7. Short-term Capital (Net)	-332	-172	-90	-458	310	-219	-56	-618	623	-1,731	-814	80	-205
8. Errors and Omissions	37	210	115	145	126	-214	-207	-387	251	638	-101	-144	174
9. Non-monetary Account Balance (5+6+7+8)	889	916	1,016	858	1,366	1,074	1,302	499	1,406	1,685	14	421	626
10. Monetization of Gold	-	-	32	41	128	400	277	183	150	221	279	365	314
11. Allocation of SDR	-	-	-	28	29	27	-	-	-	-	-	-	-
12. Revaluation Adjustments	-	-	-	-	-	-	-	-	-	560	-68	-78	83
13. Overall Balance (4+9+10+11+12)	-161	164	-54	-570	-381	-560	-1,621	-2,058	258	2,389	1,247	264	650
Foreign Exchange Reserves	1,596.8	1,525.1	1,882.7	2,422.9	3,155.4	2,574.0	1,711.4	864.7	886.1	1,061.1	2,459.0	1,959.0	2,059.0
Debt Service Ratio (%) *1	n.a.	n.a.	n.a.	n.a.	26.5	33.5	42.4	36.3	33.3	32.5	34.4	39.0	32.2
Official Rate of Foreign Exchange (Pesos / US$)	7.38	7.35	7.31	7.32	7.45	7.83	8.46	11.13	16.57	18.54	20.39	20.57	21.09

Source and Notes: Philippines Statistical Yearbook 1989, NEDA
*1 World Debt Table 1989-90 Edition, IBRD
*2 Preliminary
n.a. : not available

2. Industrial Development Policies

(1) Changes in Economic Policy and the Industrial Sector

The Philippines commenced industrialization earlier than most other ASEAN members. A main feature of Philippine industrialization has been the various kinds of protective policies used as promotion measures.

The history of industrialization in the Philippines can be divided into five phases: 1) industrialization in close linkage with U.S. industries and the U.S. market, prior to the 1950s; 2) the first phase of import substitution industrialization in the 1950s; 3) industrialization under a free trade policy from the early 1960s through to the end of the decade; 4) the second phase of import substitution industrialization under government initiative from the end of the 1960s through to the end of the 1970s; and 5) industrialization during the period of structural adjustment of the economy which began in the early 1980s.

The initial development of industry was started with the coconut oil industry and the sugar refining industry based on coconut and sugar cane, the main agricultural products, which were developed under the protection of U.S., as export industries aiming at U.S. In exchange, however, for the exports of sugar and coconut, the Philippine market was opened to the U.S., and the other industries made almost no development until the 1950s.

But, as the imports of consumer goods increased, the international balance of payments deteriorated and the government adopted a policy for industrialization of import deteriorated and the government adopted a policy for industrialization of import substitution in the 1950s. Thus, the industrialization for import substitution was promoted with the provision of preferential taxation and lending of concessional loans for industrial investments while putting import restriction, particularly regulating the imports of consumer goods. Supported by the import regulation, the prices of consumer goods were maintained at a high level in the domestic market and the imported inputs were available at a low prices by the over-valued foreign exchange rate and the import duties specially reduced for investment incentives. Under such circumstances, the investment of domestic capital and foreign capital, mainly U.S., was put on the domestic production of consumer goods for import substitution.

Entering the 1960s, the import substitution industry formed to serve the domestic demand of a limited scale hit the ceiling because the demand did not grow. As the fixed foreign exchange rate was adopted during this period, the competitiveness of export products such as coconut, sugar, copper products, etc. diminished. On the other hand, as the imports of consumer goods drastically decreased, import restriction lost its effect and thus it was relaxed, while the foreign exchange rate was depreciated to ensure competitiveness in the export trade. These measures resulted in expanding the export-oriented agriculture with a shift from even rice production, causing an increase in imports of rice. On the other hand, in the industrial sector, many of the foreign capital which had been engaged in the production for the domestic market withdrew their operation in the Philippines, losing their interest in continuing the operation because of the relaxation of the import restrictions. Thus at the end of the 1960s, another foreign exchange crisis had to be faced.

Under such circumstances, the government, on entering the 1970s, adopted a development policy emphasizing on the intensive promotion of agriculture centered on rice production and also the development of the heavy and chemical industries in the public sector. Under this policy, the development of heavy and chemical industries was carried out by the public corporations with the borrowing of foreign loans and also under various measures taken by the government for protection and encouragement; those including 1) protection of domestic industry producing intermediates, 2) lowering of the tariffs of imports of raw materials, 3) regulation of entry into industries which have excess capacities, and 4) provision of concessional loans to the strategic industries. Thus, there were active investments in specified industries. The capital deepening, as shown in Table II-2-1, substantially advanced in the fields of food industry and heavy and chemical industries such as 1) food processing, 2) beverages, 3) chemicals, 4) cement, 5) iron and steel, 6) metal products, 7) transportation equipment, etc. But in spite of such large scale investments in the intermediates and capital goods industries, the only industries that improved in labor productivity were the chemical industry and the iron and steel industry. furthermore, in the industrial fields other than those discussed here, there was those that even declined in the capital intensity.

As seen in Table II-2-2, the strategic industries mentioned before have not been developed as export industries except for the food industry but were developed as the basic industries to serve the domestic market. In other words, as these industries, as discussed before, could not become export industries because they were fostered with the measures for protection and encouragement, they turned out to depend solely on the domestic market cut off from international competition, so that they were compelled to continue the production even with low capacity utilization if the domestic market is inadequate to absorb their products. Because of such circumstances, they have not been able to renovate their manufacturing facilities to respond to the innovations of technologies, resulting in production with obsolete technologies and deteriorated manufacturing facilities and further removal from international competition.

Apart from the development of the heavy and chemical industries initiated by the public corporations, there was development of the garment industry and the electronic parts industry as export industries. Majority of these industries are consignment-based processing for exports which were developed by the private sector along the incentive measures of the government provided for the export production. These industries have made no noticeable advancement in the capital deepening because they were developed with interest to utilize labor forces available at comparatively cheap costs.

Entering the 1980s, as the result of 1) increase of import value due to the rise of the oil price in 1979, 2) stagnation of growth of export value due to the stagnant low price of the primary products, 3) increase in the payment of interests due to the increased international interest rate, etc., the international balance of payments deteriorated extremely, forcing import restrictions and cutbacks of industrial production based on imports of materials and parts.

This deterioration in the country's balance of payments forced to carry out a radical structural adjustment of the Philippine economy. The structural adjustment was required over the many sectors such as the financial, trade, industrial and agricultural sectors. However, the worsening of the debt crisis since 1983 has resulted in the suspension of a part of the structural adjustment policies, and even in a move in the opposite direction in the case of the liberalization of imports.

As described in later, the Aquino administration which came to power in 1986 decided to make an effort to restore the market mechanism which had become distorted under the previous government. It promised the IMF and the World Bank that it would continue with the structural adjustment of the economy. Thus, the government set forth the reorientation of industrial development policy, putting an end on excessive intervention and control by the government, and convented it to that based on free competition with vitalizing leadership of the private sector.

(2) Structural Deficits in the Industrial Sector

The following structural deficits remain in the Philippines' industrial sector as a result of government intervention in the economy over a period of many years with protective policies which stretched in many directions.

1. Existence of sizable publicly-owned corporations in the intermediate and capital goods industries

Many of these firms were set up during the 1970s when public investment levels accelerated to 6-8 percent of the GDP. In addition, many intervention through government financial institutions. Today, many of these firms are in the process of being privatized.

2. the large share and oligopolistic position of large companies in production

This is due to companies' specialization in certain products which has thereby allowed them to avoid competition. It is also the result of policies which made import substitution production their major targets and consequently limited the extent of competition.

3. The high-cost nature of industry

As is explained later in this report, the fostering of industry under protective policies, especially heavy and chemical industries, resulted in industry's inability to compete internationally.

4. Insufficient linkage between domestic industrial sectors

This lack of linkage is seen not only in the clothing and electronic parts sectors which were formed as consignment processing industries, but domestic industries. There is extremely little linkage between these industries and their peripheral industries.

5. The dual economic structure consisting of the small business sector and the modern industrial sector

As a result of the predominance of production by large companies, as was mentioned earlier, and the absence fo linkage between other domestic industrial sectors, there are cottage industries and small and medium-size businesses which form a virtually separate sector apart from the large companies.

6. Outdated plant, equipment and technology:

The protective policies and restricted competition mentioned earlier have inhibited the rationalization efforts of businesses and even the large businesses have not sufficiently undertaken the updating of plant and equipment. In addition, a decline in the rate of plant operation and an increase in debt due to the recession in the 1980s caused businesses with modern plant and equipment to go bankrupt and for foreign investment to withdraw from the country. Conversely, businesses relying on old plant and equipment were able to survive because of their low debt burden. Since then there has been little investment in plant and equipment, and not only smaller business, but large businesses as well, have not been renewing their plant and equipment.

7. Low capacity to absorb employment

Investment incentives aimed at the capital-intensive heavy and chemical industries and the government's industrial projects in this area have failed to create more employment. Lack of linkage between these industries and peripheral industries may also be attributable to this fact.

8. Concentration of industries in Metro Manila

since the end of the 1970s the government has adopted policies to encourage the dispersal of industries outside Metro Manila. However, this has not been as successful as had been anticipated. The reasons for this include the following: 1) the regions do not have the required infrastructure; and 2) the concentration of government offices and agencies in Manila has resulted in an even wider gap between the infrastructure and social services of Manila and those of other regions.

(3) Economic Policies under the New Government

1) Medium-term economic development plan

Since coming to power in 1986, the new government has adopted The Medium-Term Development Plan (1987-92) and has set to work at restructuring the economy.

The Medium-Term Development Plan sets forth its development objectives as follows: 1) the alleviation of poverty; 2) creation of employment; 3) promotion of fairness and social justice; and 4) the achievement of continual economic growth. The key task given to this development plan is the restoration of a rural and agricultural economy driven by demand, and the agricultural sector is designated as the most priority sector of the development. That is to say, it is aimed at engaging the unemployed and underemployed workforce in the rural regions in highly productive production activities, thereby eradicating poverty in rural areas as well as increasing the level of their purchasing power. The industrial sector is regarded as the next most important sector to be developed after the agricultural sector. Just as with the agricultural sector the alleviation of poverty and an increase in purchasing power, promotion of local industry and the regional dispersal of industry is expected for this sector. In this way, as well as setting the eradication of social instability as an immediate objective, the plan is attempting to achieve the sustained economic growth through balanced growth between industry and agriculture and between the center and regions, expecting the expansion of the domestic market.

The trade and industry policy package which has been formulated as a means of reaching these goals has been based on the principles of comparative advantage and industrial efficiency. The package comprises the following main points.

1. The plan will be implemented using a sectoral planning approach, including a sub-sector development program, and will pursue maximum private sector participation.
2. Various kinds of government support programs will be implemented to promote micro cottage, small and medium businesses.
3. Preferential tax measures will be continued to encourage investment but measures to minimize distortion in the market will also be examined.
4. The liberalization of trade will be pursued by abolishing the import license system and the import quota system.
5. Exports will be promoted centering upon non-traditional export items.

2) The "Memorandum of Economic Policy" and the "New Economic Policy"

The government holds the view that many other objectives must still be achieved in order to reach the main goals set out in the Development Plan. To this end, in March 1989, when it made a request to the IMF for an extension of credit, it issued its Memorandum of Economic Policy (MEP) which consisted of an economic plan aimed at improving and also extending its present policies. The memorandum is to be reviewed 5 times during the period it covers up to 1992. A New Economic Policy was announced in July 1990 as a revised edition of the MEP at the time of review. The framework of the MEP can be summarized in the following manner.

Strong continued growth requires both 1) the efficient use of resources; and 2) considerable increase in investment. There is no longer the idle capacity as there once was, but rather constraints on production capacity have become tighter and large investment become necessary in order to maintain the growth. Therefore, the efficient use of resources and an increase in the value of investment are required for strong continued growth. Rather, constraints on production capacity have become tighter and large investments are indispensable for maintaining growth. Therefore, priorities for development must be switched from the efficient use of existing resources to an increase in investment and the investment must be concentrated in efficient production-related activities.

The recovery of investment requires 1) the improvement of the investment climate; and 2) the development of financing sources.

The following are required in order to improve the investment climate.

1. The continuation of restructuring in order to improve both the production and the investment climate. Specific measures required include: a) raising incentives; and b) removing the distortions and control which have benefitted only the limited people and which have inhibited the activities of the private sector; through reforms of the public business sector, the financial sector, trade, and through agricultural reforms.
2. The implementation of a cautions fiscal policy which would assist in improving business confidence.
3. The expansion of public investment on top of increased investment in the private sector.

The following targets have been set in order to develop financing sources.

1. An increase in national savings.
2. Efficient use of foreign loans.
3. Decreasing the deficit in the current account balance and increasing foreign exchange reserves.

The following points were included in the New Economic Policy which was issued as part of a review of the implementation of the MEP.

1. Unifying the import tariff structure into three categories (raw materials, intermediate goods or semi-finished goods, and finished goods)
2 Ensuring the central bank's independence from the government.
3. Abolition of incentive policies for industries which had been protected until recently.

3) Response to recent economic reforms

Criticism of these recent economic reforms have come from two quarters. Firstly, there is the criticism that not enough attention has been paid to the market and price mechanisms. Criticism concerning this area stresses that further reforms should be made in the following areas.

1. Adoption of complete floating exchange rate system

It has been said that it will not be possible to remedy the country's chronic deficit unless a complete floating exchange rate system is introduced for the peso (Philippine Chamber of Commerce and Industry). The introduction of this system will naturally bring with it certain disadvantages and emphasis should be placed on adopting policies to reduce the impact on the poor (UP economists).

2. devaluation (UP economists).

3. Abolition of price controls (PCCI)

The other criticism which has been voiced regarding these economic reforms has come mainly from industry circles such as the PCCI and the Buy Philippine Made Movement. They have asked that the implementation of these economic reforms be postponed. Specifically, they say that:

1. Because the distortion in the industrial structure which has been built up over the years still exists today, the implementation of this type of policy will result in a loss in competitiveness for existing industries.
2. If these policies are implemented without the simultaneous implementation of other liberalization policies, it will not be possible to maintain overall balance, and instead the distortion will become greater, thereby causing harm to existing industries.

(4) The Direction of Present Industrial Development Policies

1) Introduction

Industrial development policies have also been reviewed in line with the direction of economic policies outlined above.

The various kinds of policies which are being adopted today and those which were adopted in the past may be divided into two categories. First, there are those with the objective of setting a specific course by either protecting or encouraging specific economic activities. Secondly, there are those which provide assistance by publicly investing in activities which are vital for economic activities. This is done in cases where the free market economy makes it difficult to attain the objective at hand.

2) The government's attitude toward protective and incentive measures

The attitude of the present government toward these policy measures may be basically as follows.

a) International trade policy

The basis of the international trade policy consists of: 1) increase in the neutrality, fairness and clarity of industrial protection; and 2) exposing the oligopolistic businesses , which are a typical of the distortions caused by the past industrial policies, to international competition. The followings are in the process of implementation in accordance with these objectives: 1) reducing by as many as possible the number of import items subject to restrictions and, in cases where import restrictions are necessary, using tariffs as a means of control; 2) lowering the higher limit of tariffs; and 3) simplifying tariffs.

b) Investment promotion policy

The principle behind the BOI's investment promotion policy is that a preferential tax system should be applied only if the market has an incomplete gradually. Accordingly, the BOI is shifting its emphasis to activities related to the improvement of an investment environment and the public relation activities for promotion of investment.

Meanwhile, policy measures such as promotion programs of the the automobile assembly industry and its parts industry are also carried out on the contrary to the above principle.

c) Financial policy

The principles behind the country's financial policy is to put an end on the protection of selected industries, and to operate the financial system under the free competition market mechanisms. This is represented by liberalization of interest rates and abolishing of institutional finance to which preferential interest rates are applied. However, many problem areas are left unsolved to achieve establishment of effective finance system.

3) The government's attitude toward support and promotion measures

a) Reorganization of the industrial structure

The largest task faced by the Philippines in regard to its industrial structure is the privatization of government-established businesses which have been the largest single factor behind the distortions caused by industrial policy to date. The inefficiencies accumulated in these businesses are attempted to be reduced and the resources are tried to be mobilized by exposing to market competition.

b) Assistance for export promotion

The promotion of exports itself is one step for achieving industrial development. This is expected to contribute to achieve the quantitative and qualitative growth of the industrial sector and growth in linkage industries. The export promotion must also be carried out through neutral and fair export promotion policies, and it should not be biased towards specific industries.

(5) Conclusion and Recommendation on the Direction of Industrial Development Policy

1) Introduction

As has been seen, the protective and incentive measures were often adopted by the Philippines with the objective of encouraging the development of sectors which had been made priorities by the industrial development policies of the past. The outcome was that these measures brought about serious distortion in the industrial structure as already been mentioned. Today, when due consideration has been given to the situation, there is basically no inclination towards the application of protectionist and incentive measures. Rather, the policy emphasis is put on liberalization and neutralization of the protectionist and incentive system which has built up until recently.

However, it is necessary to take note of the fact that the existence and functioning of a freely competitive market are prerequisites for any policies based on this kind of market and price mechanism. When attempting to promote new industries in developing countries, it is probable that strong competitors exist in the international market with the new comers being found difficult to cope with them immediately. In such cases, it is necessary to make sure that right from the beginning there is the capacity to come out on top when competing with competitors which are already involved in the international market. One method which may be adopted is to receive assistance from a foreign business in an advanced country which already possesses a certain level of competitiveness. Another method is to provide incentives for the industry to improve themselves on a public level for a limited period of time in the initial fostering stages. This latter method has been adopted by many developing countries while they have carried out industrialization and has proven to be successful. Learning the lessons from these examples, the Philippines is recommended to examine the possibility to apply the incentive measures for a limited period at specific purposes.

The present policies to correct distortions which have caused by policies in the past are undoubtedly important in the sense that they put in place conditions required for future industrial development. However, this alone does not constitute the establishment of conditions considered adequate for carrying out industrial development. The assisting and promoting measures for industrial development is also required. The Philippines too is aware of the importance of adopting such measures, and has been making efforts accordingly. However, they are still inadequate in the following points:

1. Reorganization of the industrial structure in the private sector

Sub-sector studies have been carried out for many sub-sectors under the title of a sectoral approach. However, as yet no long-term direction has been set out which suggests the development strategies for each sub-sector.

2. Action plan for improvement of a technological infrastructure

There is an action plan which was prepared through a joint public-private initiative, and part of which has been implemented. However, for the reason that it has, not been able to find any financial support, most of them are remained suspended.

3. Improvement of an infrastructure

The infrastructure improvement is quite unsatisfactory from the standpoint of the role it has to play in pushing industrial development along. What's more to the point, the present infrastructure situation does not meet even the socioeconomic needs when taking into account the unstable power supply, poor communication system and chronic state of traffic congestion, etc.

Contained below is a recommendation on a development strategy for the Philippines on the perspectives common to the 3 sub-sectors comprised of this study.

2) Recommendation on an industrial development strategy

While on the one hand advanced industrialized countries such as the United States, Japan and those in western Europe are experiencing an unprecedented labor shortage, on the other hand, in developing countries around the world technology levels are being improved; thus, there is an ongoing change in an industrial structure on the international level. In the past businesses in the various developed nations around the world regarded of developing countries as export markets for their own products. Today, however, these developing countries are awarded a more positive status as sources of products or semi-finished products for their own markets. In this way, businesses are making an effort to carry out their business activities on an international level. The NIES in Asia were early to take steps to meet such developments, with changing over from policies for industrialization through import substitution to policies which promoted exports , specializing in industries, and actively introducing technology in order to improve productivity. Thus, they made a success of their own industrialization. Developments of the business activities at an international level have not only been taking place between the businesses in industrialized countries and developing countries, but have also been taking place between NIES and developing countries.

The basic strategy for industrial development in the Philippines should be, as has been the case in the past experiences of NIES, to achieve industrialization acceptable on an international level by making use of their advantages in the process of international developments of industry. In any event, it is important that this sort of industrialization is not achieved by only a number of large businesses which have been protected as was seen in the past, but that it is achieved as a result of a joint effort between large businesses and small and medium-size businesses or through development of small and medium businesses themselves. By doing so it is anticipated that most of the problems faced by the industrial sector will be resolved, the industrial sector will make a contribution towards the creation of employment, and that it will prove conducive to alleviating poverty and increasing purchasing power.

In all three sub-sectors covered by the study there was a group of large-scale businesses already developed as export-oriented businesses, a group grown out of foreign capital businesses, and small and medium-scale local businesses which existed on a different level from that of these business groups. It was difficult for these smaller scale businesses to gain direct access to export markets, and to the upper end of demand on the domestic market. Their technology, production management, and management is still insufficient to meet the needs from these markets. Their access to financial resources required for modernization is limited. It is not easy to foster and develop the small and medium businesses as the export business, but regardless of this, the fostering these businesses is highly important and should be regarded as a key strategy for industrial development.

In order to achieve such targets, the followings are recommended as development measures common to each of the sub-sectors.

1. Increase opportunities to facilitate access to export markets and to demand at the upper end of the domestic market. By so doing, firstly increase in exports,and at the same time, improve the understanding of each firm on the requirements of these markets in regard to technology, production management, marketing and management.
2. In order to comply with the needs of these markets efforts must be made at company level to make improvements in production technology, production management, marketing and management. This will contribute to develop markets or to promote the formation of tie-ups with overseas companies,further paving the way for undertaking independent initiatives in the future.
3. The strengthening of industry should be supported by making improvements to the infrastructure, technological infrastructure, the financial system, and the educational and vocational training system.

The basic directions of development strategies for each sub-sector are contained in the section on each sub-sector.

In order for the industrial development to be most effective in a short period as possible, the following points are recommended to be taken into consideration:

1. Necessity of incentive measures for supporting small and medium businesses, who are not focused in development policy, in their efforts to find their market either in export market or upper end domestic market

In the event of difficulty to maintain a market and price mechanism based on free competition, as has been mentioned earlier, it is necessary that incentive measures be adopted to help small and medium businesses for them to make efforts to find their market either in export market or upper end domestic market in a bid to improve the situation to a level where it is possible to compete on an even footing. Even after this has been done there should be continual monitoring to see whether this market and price mechanism is being maintained, and countermeasures should be implemented if the need arises. The following situations related to this kind of scenario were found to exist in the sub-sectors covered by this study.

a. There are delays in the adoption of measures aimed at promoting small and medium-scale businesses as a result of the industrial policies previously adopted which mainly directed to large-scale development projects. The result is that there are many small and medium-scale local businesses which have no chance of gaining access to export markets or to the upper end domestic market.
b. Also as a result of this, within the same sub-sector a dual structure has emerged. This consists of, at one level, a group of large and medium-scale businesses which has undergone relative modernization benefited with protection and incentive measures and a group which lags behind in the modernization of its equipment and technology. Ties between these two groups have been severed. Typical example of this in the metal and engineering industry is that of automobile industry and the parts die-making industries. The automobile industry relies their supply of parts mainly on import, leaving domestic metal and engineering industry a supplier of limited parts of simple specifications. In the case of the sawmilling industry within the timber and timber product industry, it has grown placing an emphasis on export markets rather than on the domestic furniture industry. As a result, the supply system of lumber is not satisfactory for the furniture industry in supplying it according to their request.
c. The concentration of the infrastructure in the Manila region has resulted in the concentration of industry in this region. This has had the adverse effect of retarding the development of industries in the regions.

The incentive measures, however, should be applied only to those who have intention and desire to improve themselves instead of applying to all regardless of their eagerness.

2. The importance of the implementation of the promotion measures of small and medium-scale businesses in strategic and preferential basis

In recent years there have been urgent calls for policies aimed at promoting small and medium-scale businesses, and these have resulted in efforts being made to strengthen these policies. At the present time, the BSMBD, which is responsible for small and medium business development, is in the process of preparing a "Small and Medium Business Magna Carta". The charter intends the coordinated implementation of small and medium business policies of finance and guidance in technology and management which until recently had been carried out independent of one another. However, in today's climate of growing debt when there is no spare money around, it is hard to believe that efforts directed at the widespread and complete implementation of these small and medium business promotion policies will have any real effect. Instead of doing this it is necessary to shift the focus away from policies aimed at provided assistance across the board to providing strategic assistance to priority cases. That is to say, it is important to elevate the position of those which are strongly interested in participating in export markets and in the upper end of the domestic market, and by doing so stimulate other businesses.

When taking into account the fact that most of the business eligible for such support is concentrated to Metro Manila, this policy may run counter to the basic policy direction of industrial dispersal. However, if compared to the past policy to place an emphasis on large-scale projects, this policy is concerned with small and medium businesses. It is therefore possible to expect for them to establish a relationship of complementation and subcontracting relationship with smaller businesses in the regions, which will contribute to the dispersal of industry among the regions. Such examples are already being seen with regard to the handicraft and garment industries, and there is great potential in the furniture industry.

3. Necessity of assigning a government department responsible for sectoral approach

As has already been mentioned, the adoption of a sectoral approach has been suggested as one way of carrying out industrial development policies, and basic sub-sector studies in many sub-sectors have already been carried out for this purpose. This approach, consisting of a comprehensive examination of the sub-sector issues and implementing various measures in preferential basis, it can be said to be an extremely effective approach. However, in the case of the Philippines it is not clear which government department are mainly responsible for such approach. Although the BOI/Industry Group, BETP, BSMBD and the DOST contained within the Department of Trade and Industry are each in charge of investment policy, international trade policy, small and medium business policy and industrial technology policy respectively, and have been allocated their various roles, there are no bureaus in charge of the comprehensive planning and monitoring of basic policy for specific industry sectors.

The system of having an inter agency committee is generally adopted when it comes to matters involving a number of departments and agencies which have been allocated various duties. This system may be effective for integrated coordination among the departments and agencies beyond an organizational framework. However, there is the danger that when using this inter agency committee system all that will be done is to allocate each department with a different task as the occasion arises.

Instead of this it is considered necessary to assign agencies in charge of the sectoral approach which have the capacity to formulate a comprehensive and long-term vision of policy for the responsible sector, plan policy, make proposals based on the vision and analyze the effectiveness of the policy. At a minimum it is essential that these agencies:

a. Have an understanding of the structure of the industry in question and have relevant statistics and data at hand,
b. Have an understanding of relevant policies, legislation and systems and their effects, and
c. Have a sufficient capacity to have effective policy dialogue with the industry and make coordination with regard to policy implementation.

4. The importance of using the vitality of industries and providing assistance for strengthening the organization of industry associations

As has already been mentioned, the most important thing for the Philippines to do in relation to its industrial development is to make use of the international development of industrial structure and utilize the vitality of the private sector based on such development. It may be one of effective means of achieving this objective to foster industry associations, and use these as channels for coordinating government and industry activities, and requesting cooperation from industry. In addition to this, the fostering of industry associations is important in the sense that they act as a check in regard to bias in the government's policies. Industry associations in the Philippines today generally 1) include those which are to promote friendship among members; 2) do not comprise of many members from smaller scale businesses in particular; and 3) have a weak financial base. It is desirable that the government implement measures aimed at fostering the appropriate association. The measures through which industry associations would be fostered would include 1) the preparation of legislation which would define the qualification of adequate industrial association for this purpose; 2) the provision of financial assistance including tax exemptions for the operation of associations; and 3) the offering of incentives to members as a means of encouraging membership.

(6) The Implementation of Industrial Development Projects and Industry Associations

1) Industry associations today

In general, there are two types of associations which have been established for the purpose of rationalization and stable operation of industry. These are those which are made up of businesses engaged in the same industry and those whose membership consists of businesses which are situated in the same region. The Philippines also has the two types of industrial associations, namely, the Chamber of Commerce and Industry (PCCI) beneath which there are regional chambers of commerce and industry, and various associations whose membership is derived from a single industry.

In almost all industrial sectors in the Philippines, the industry associations were made up of the major businesses in the sector. Although the objectives of these organizations vary from one association to another, they have, for the most part, been established for the purpose of sharing information, conducting mutual training, and for the purpose of engaging in joint activities of one sort or another.

For some considerable length of time these major associations of the various industries in the Philippines have acted as a mouthpiece for their respective industries and have formed the link with the government. Since the government recently started adopting policies to make use of the vitality of the private sector, the government has often appointed representatives to the various liaison committees of representative industry associations for the purpose of hearing the opinions of the industries. Industries have also acted constructively by sending reports containing their own views to the government and to the Congress.

However, industry associations are associations which are formed on a voluntary basis. Generally speaking, businesses which produce products for export or for the upper end of the domestic market are well organized, whereas cottage industries and small and medium-size industries which target local domestic markets and the lower end of the market are usually not very well organized. In many cases, Chinese-origin business men have formed their organizations separately, or do not attempt to join the appropriate industry association.

In the case of the furniture industry, the CFIP is the sole industry association which includes rattan, wooden and other types of furniture manufacturers. The activities of the CFIP cover a wide area. Although there is another association which is made up only of members which are furniture manufacturers in the Angeles district, no information is available.

As for the die-making industry, the MIAP has a metal mold industry sub-committee, which is the sole industry association representing the industry at present. The industry itself is still young and organization basis is still weak. Also, forming links with the parts processing industry, automobile, electrical home appliance and electronic parts industries is indispensable when implementing the various kinds of development programs for the die-making industry. It is desirable that businesses from these associated industries take part as supporting members as the die-making industry develops.

In the case of the computer software industry, the software development sector and the data entry sector are covered by their own industry associations, the PSA and the PASEC respectively. However, cottage industries and small businesses are not yet very well organized, and there are even cases of some foreign capital businesses and large businesses not belonging to these associations. There are also industry associations such as the PCS and the ITAP which are made up of the same members and which carry out similar activities. The PSA, PADEC and the ITAP share the same secretariat. From this standpoint, as well as increasing the number of members, there also needs to be a clearer demarcation of functions among these industry associations.

2) Implementation of industrial development programs and industry associations

Promotion of voluntary groups, industrial organizations and cooperative associations in the private sector is cited as one of the goals of the small and medium firm development policy in the "Magna Charta" for small and medium firms now being drafted by BSMBD. However, no concrete measures are under way for that purpose at the moment.

The activities which industrial organizations generally carry out for the stabilization and rationalization of management in the industry include the following:

1. Activities for guidance and study/research: With a view to improving and developing the subject firm,
   a. Guidance and education
   b. Collection and supply of data information and study/research
2. Undertakings for rationalization: Unification of quality, standards, and measurements without restricting free transactions, necessary for the advance of technology, improvement of quality, reduction of costs, improvement of efficiency and other management rationalization measures
4. Cooperative economic undertakings
5. Representation of the industry in expressing views or in negotiations and coordinations with other organizations with respect to implementation of projects
6. Understanding of the actual situation of the subject industry beginning with the views and actual situations of members

The chief activities of industrial organizations in the Philippines generally include undertakings for guidance and study/research activities, representation of the interests of the industry and coordination activities.

However, when the situations of the three sub-sectors under study and the needs of developing these sub-sectors are considered, the monitoring and understanding of the actual situation of the sub-sectors is the foundation of all undertakings for their improvement and development and activities for this purpose should be given priority for implementation. The undertakings for guidance and research, representation of the interests of the industry and coordination activities currently being done should also be done more actively. Rationalization undertakings, mainly unification of quality, measurements and standards, should be considered so far as they do not restrict free transactions.

In addition to the above-mentioned undertakings, the following measures are necessary in the Philippines:

1. Since the financing system for small and medium enterprises is insufficient,the industry associations are recommended to assist to provide basis for financial guarantees or mutual aid systems to help develop the financing system.

2. It is recommended to study the possibility of undertaking such activities as undertakings to complement the government's activities by informing individual firms of various encouragement and preferential treatment programs and assisting them in procedural matters when applying for these programs, thus, contributing to the improvement of the management of the industry.

Organization of industry associations is an effective means mainly for small and medium enterprises to voluntarily solve various problems they are faced with. In the Philippines, the ratio of members organized is not high enough. It is recommended that the government actively consider the following two measures to improve the ratio:

1. Financial assistance
2. Preferential treatment for participating members.

All existing organizations are weak in terms of operational base. Existing full-time secretariats have only one or two staff at the most, and offices are often rooms rented from member firms. To strengthen their operational bases, the government might consider offering them financial assistance when they played the secretary role in implementing development programs or are engaged in intermediary activities between the government and the industry and might also give them preferential tax treatment for the operation of organizations (reduction of taxation rates, counting in of various reserves as losses, etc.).

Recommendations in regard to each sub-sector industry association are described in the individual chapter for each sub-sector.

Table II-2-1: Comparison of Manufacturing Industry Characteristics, The Philippines, 1960 and 1980

(Unit: 1,000 pesos)

Code	Industry Group	1960		1980	
		FA/L	VA/L	FA/L	VA/L
311/312	Food	6.52	9.88	10.98	7.40
313	Beverages	5.41	15.20	12.31	14.63
314	Tobacco	2.70	6.53	3.12	18.85
321	Textiles	6.99	4.17	8.80	4.17
322	Wearing Apparel except Footwear	1.33	2.44	1.26	2.03
323	Leather and Leather Products	4.01	4.78	3.13	2.67
324	Footwear	1.48	2.55	1.78	1.57
331	Wood Products	4.77	4.01	5.11	13.98
332	Furniture and Fixtures	1.75	2.72	1.52	1.83
341	Paper and Paper Products	14.12	10.11	17.88	11.09
342	Printing, Publishing	3.61	5.29	5.59	4.60
351	Industrial Chemicals	17.56	7.82	23.48	30.08
352	Other Chemical Products	6.29	16.72	6.46	14.34
353	Petroleum Refineries	62.62 1)	132.18 1)	68.89	207.00
355	Rubber Products	9.35	11.27	5.24	8.11
356	Plastic Products	4.72	6.04	4.90	4.73
362	Glass and Glass Products	8.54	9.77	8.96	5.79
368	Other Non-metallic Mineral Prd.	12.97	8.76	16.29	8.82
371	Iron and Steel Basic Industries	9.34	7.48	14.67	35.35
372	Non-ferrous Metal Basic Ind.	6.77	6.77	5.69	9.13
381	Fabricated Metal Products	0.06	7.56	3.35	4.10
382	Machinery except Electrical	1.95	9.074	5.43	4.45
383	Electrical Machinery	4.17	8.40	3.26	6.02
384	Transport Equipment	4.95	9.07	8.05	9.09

Notes: 1. FA/L: Value of fixed assets per employee
VA/L: Census value added per employee
2. The 1980 data have been deflated by an index of 700% which is the approximate price increase for manufactures between 1960 and 1980.
1) In 1962

Sources: Hooley, 1985

Table II-2-2: Export Rate of Total Output by Sector, The Philippines, 1983

(Unit: million pesos)

Sector Code	Description	Export (a) Value	Export (a) % (a/b)	Total Output (b)
1	Agricultural Crops incl. Agricultural Services	2,388	4.1	57,648
2	Livestock and Poultry	21	0.1	25,555
3	Fishery	222	1.0	21,546
4	Forestry and Logging	686	7.4	9,215
5	Metallic Mining	6,143	81.7	7,515
6	Non-metallic Mining	54	2.2	2,505
7	Food Manufactures	12,665	10.7	118,324
8	Beverage and Tobacco	87	0.6	14,913
9	Textile and Leather Products	7,139	25.9	27,526
10	Wood and Wood Products	3,790	28.5	13,309
11	Paper, Publishing and Printing	155	2.7	5,823
12	Chemicals & Chemical Products except Petroleum	913	3.5	26,007
13	Petroleum Products	1,607	4.1	38,884
14	Non-metallic Mineral Products	212	2.9	7,347
15	Basic Metal Industries	295	2.9	10,324
16	Metal Products and Machinery	10,163	30.7	33,135
17	Miscellaneous Manufactures and Scrap	1,516	40.2	3,774
18	Construction	912	1.7	54,465
19	Electricity, Gas and Water	0	0.0	15,037
20	Transportation, Storage and Communication	2,945	6.7	44,205
21	Wholesale and Retail Trade	8,587	10.3	83,662
22	Finance, Insurance and Real Estate	326	0.9	35,659
23	Government Services	0	0.0	17,539
24	Private Services	16,441	34.6	47,476
	Total Produced Inputs	77,267	10.7	721,392

Source: The Interindustry Accounts of the Philippines: 1983 Update, NEDA

3. Investment and Trade Policy

3-1 Investment Policy

(1) The Role of Private Direct Foreign Investment

Increasing attention is being focused on the role of foreign investment in the economic cycle. In particular, the task of economic management under a growing debt burden is of critical importance.

Filipino investment policy does not provide a separate set of incentives for local and foreign investment; instead, the two are regulated under a single legal system providing incentives for new investment in general. In the 1987 constitution, the following expectations were indicated for the role of foreign capital.

1. To promote socio-economic development
2. To complement rather than act as a substitute for local investment
3. That foreign capital should be brought in to sectors of the economy which would contribute to the achievement of targets laid out in development plans

Capital formation in the Philippines are sourced as follows.

- Capital formation
  - Filipino sources
    - Government (A)
    - Private (B)
  - Foreign sources
    - Loans (C)
    - Aid (D)
    - Direct investment (E)

For the Philippines, whose economy must be managed under a sizeable debt burden, private direct investment (B + E) takes on a special significance, since public investment (A) has necessarily been limited by budgetary constraints. In 1989, the current account deficit amounted to 3.3 percent of the nation's GNP (figures for 1987 and 1988 were 1.49 percent and 1.0 percent, respectively).

As of the end of 1989, cumulative outstanding foreign debt (C) totaled $27.6 billion, resulting in a debt service ratio of 31.47 percent. Further growth in this figure is limited. Together with efforts to attract aid (D), work is being rushed on the development of an effective base for the securing of new money in order to continue development.

For the economy to regain a sense of buoyancy and to create a better climate for the promotion of exports, private investment from both local and foreign sources must first be effectively utilized.

Table II-3-1: Macroeconomic Indices for the Philippines

	1987	1988	1989
Real GNP growth (%)			
Targeted	6.5	6.9	6.7
Actual	5.9	6.8	5.6
Current account deficit (as percent of GNP)	1.49	1.0	3.3
Public sector deficit (as percent of GNP)	2.2	3.1	4.0

Sources: "On the 1990 Economic Measures," UP School of Economics.
"Review of Performance in First Semester 1990," BOI.

Foreign investment contributes to enhance productivity by increasing production, creating new jobs, and providing for the transfer of technology and management know-how. It also aids in the effective use of domestic resources and the improvement of industrial efficiency. In particular, the attraction of export-oriented foreign investment serves both to secure foreign exchange and to reduce the debt burden. In the Philippine Assistance Program Agenda of May 1989, it was suggested that during 1989-92 private direct foreign investment could be expected to increase at a net annual rate of 60 percent. Reflecting this, the BOI, which serves as the point of entry for foreign investment, has since 1988 been setting its annual investment targets based on project cost.

(2) Trends in Underlying Policy Formation

The Philippines has been essentially aggressive in its efforts to attract foreign investment while at the same time maintaining a cautious position. Specifically, the introduction of foreign capital has been selectively permitted in certain fields and regions while maintaining the principle of Filipino majority ownership.

The New Omnibus Investment Code, enacted in 1987, is a compilation of all foreign investment legislation and the various incentive systems being administered by the DTI through the BOI and the Export Processing Zone Authority.

The main thrust of the Code has been the reduction of red tape and the introduction of incentives in a move to bring the Philippines in line with other ASEAN nations. For example, a corporate income tax holiday (six years for firms with Pioneer status, four for those without) was enacted. Other measures included tax deductions for labor costs, duty-free importation of capital goods and auxiliary components for the same, and exemption from the Contractor's tax.

Non-tax measures incorporated in the Code include the relaxation of restrictions on hiring foreigners and the simplification of customs procedures. Furthermore, the upper limit on foreign equity permitted without the advance authorization of the BOI was raised from 30 percent to 40 percent.

Revisions made to the New Omnibus Investment Code can be characterized as follows.

First, performance-based incentives for net local content and net value earned were removed and replaced with the corporate income tax holiday. In addition, some complexity were left on the general guidelines and operation of the measured capacity and Investment Priorities Plan (IPP), both of which had played a major role in previous guidelines.

The DTI's Industry and Investment Group is the main administrative body for foreign investment. The group comprises the following organizations: the Board of Investments, the Bonded Export Manufacturing Board, the Export Processing Zone Authority, and the Construction Industry Authority of the Philippines.

According to the BOI, the qualities of desired investment are as follows:

1. Employment creation
2. High local content
3. High degree of linkage between industries
4. Support of regional dispersal policy
5. Export orientation

In line with these policies, firms newly locating in the Metro Manila since 1989, have been ineligible for the incentives laid out in the Omnibus Investment Code.

In 1990, the general trend has been for a reappraisal of foreign investment policy in a variety of forms by government-related organizations. This movement has been characterized by the cooperation of the executive branch of government, including the Houses of Congress, the Ministry of Finance and NEDA, in planning efforts. Future results of these efforts are seemed to have a major impact on the Filipino investment climate.

The main revisions are as described below. Senate Bill 1558 (commonly referred to as the Paterno Bill) is particularly important in that it suggests a move towards the relaxation of restrictions on the sectors in which foreign investment is allowed as well as the ratio of foreign to domestic capital, based around the introduction of negative list. A related development was the introduction of the so-called Teves Bill in the lower house. At the core of this proposal is the establishment of a three- to five-year transitory provision to be invoked during implementation of the negative list. This bill is now under deliberation.

Moves for main revisions fo foreign capital introduction in the Philippines (as of end of 1990)

•Senate Bill 1276 (Senator W.E. Tanãda)	- The restriction on debt:equity ratios for multinational corporations operating in the Philippines is strengthened to 10 percent (under previous legislation, the ratio was set at 40:60-60:40).
•Senate Bill 1558 (Senator Vicente T. Paterno)	- The 40 percent limit on foreign equity is relaxed for specified projects. - 100 percent foreign ownership is allowed for export corporations (defined as those companies exporting at least 60 percent of production). This figure must be scaled back to 40 percent within 20 years, however. - Negative lists (entrusted to NEDA).
•Senate Bill 1562 (Senator Vicente T.Paterno)	- Incentives for multinational corporations regional or area headquarters or regional warehouses are cut back (under BOI authority). - The minimum annual remittance is set for $50,000.
•Executive Order No. 413 (signed by President Aquino, (suspended) July 19, 1990)	- Import duties are to be simplified into four categories - 3 percent, 10 percent, 20 percent, and 30 percent
•Department of Finance Memorandum to DTI, July 20, 1990	- New authorizations for tax exemptions and reductions are to be gradually scaled back. - BOI operations are to be expanded. - Foreign equity regulations are to be liberalized.

(3) The Philippines and the Foreign Investment Boom in Asia

As was indicated in the progress report, the world situation currently facing the Philippines calls for a clearer selection of policies in terms of promoting private direct foreign investment.

The first wave of foreign investment in Asia came in the latter half of the 1960s; later, in 1973-74, a second phase of activity emerged. In the second half of the 1980s, a so-called "third wave" of investment was seen in Taiwan, R. Korea, Hong Kong, Malaysia, Thailand, and thereafter proceeding to Indonesia and the Philippines.

Investment activity in the Asian region during this period has been characterized by several distinctive features. First of all, during the shift from the NIEs to ASEAN nations, restrictions have been relaxed and the directions for liberalization have become more clearly laid out in government policy. Second is business-related diversification. In addition to the opening of what were once "sensitive sectors," the mutual exchange of capital among Asian nations is also proceeding. In particular, Taiwanese and R. Korean capital is shifting to the ASEAN nations. Finally, these foreign investors are placing an increasing emphasis on existing infrastructure -- port facilities, communications, industrial estates, etc. -- during their selection of investment sites.

In recent years, the countries and regions of Asia have been proceeding with industrial choices at a rapid pace based on their comparative advantages, and a variety of restrictions have been relaxed in the period since 1986. The establishment and presentation of industrial policy are becoming an important reason for this. The relaxation of restrictions can be broken down into the following categories.

1. Rollback of the minimum investment guidelines for foreign investment: R. Korea, $200,000 to $50,000; Thailand, 5 million baht to 1 million baht; Indonesia, $1 million to $250,000
2. Expansion of the fields in which foreign investment is permitted: Taiwan, opening of the service industries; R. Korea, greater participation permitted in small and medium enterprise sectors; Indonesia, the lifting of a ban on wholesale operations for foreign-affiliate joint ventures; and in the NIEs, the partial opening of the financial sectors such as insurance and banking
3. R&D incentives: Taiwan and Singapore
4. Relaxation of investment ratio restrictions: Taiwan, Malaysia, Indonesia
5. Subdivision and reevaluation of investment promotion regions: Thailand, Malaysia
6. Adoption of negative list: Republic of Korea, Taiwan, Indonesia

Of special note are the relaxation of restrictions on foreign investment ratios and the creation of incentives for development in underdeveloped regions. Both of these are characterized by a transition to new types of incentives based on the degree of export contribution (i.e., performance criteria). Here, the cases of Thailand and Malaysia will be studied and their respective incentives for foreign investment examined.

[Thailand]

In August 1986 the criteria for foreign investment incentives which had been in effect since 1983 were revised and followed by substantive improvements in the investment environment. The four newly-established incentive criteria were as follows:

1. Previous policy, which emphasized new investment only, was revised to include facility expansion at existing corporations.
2. Company efforts to improve production efficiency are to be encouraged with the objective of improving international competitiveness.
3. Concerning the influx of Japanese firms investing as a countermeasure to the strong yen, the use of local companies as subcontractors should be promoted, and production capacity at existing firms should be maximized.
4. Technological development assistance for the manufacturing industry is to emphasize export industries, agro-industries, and intermediate material industries.

Based on these new criteria, several improvements were made in the programs and the organizations supporting them.

The export industry promotion policies adopted by the Thai government can be grouped into three categories: (1) tax reductions and exemptions and other investment incentives for export firms; (2) development of the related infrastructure; and (3) the liberalization of imports of capital goods, raw materials, and intermediate materials. The following section will concentrate on two aspects of the program improvements.

First, the government actively adopted performance criteria for its investment incentives. The concept of performance criteria was linked to the attraction of foreign investment, and substantive incentive content was thereby presented to foreign investors.

In October 1986, the minimum amount of foreign investment for export industries, excluding land costs and operating funds, was lowered from 5 million bahts to 1 million bahts. Next, the export ratio, which was the primary condition for acceptance of independent foreign investment, was lowered from the initial 80% to a figure of 50% during the first two years of operation. Incentives for export firms were also strengthened, and the exemption of imported machinery from import and business taxes was extended to cover not only initial installation but renovation and spare parts as parts. In December of the same year, the tariff system was simplified to promote exports.

Included in the classification of export corporations are not only those firms meeting the above standards but also those companies manufacturing components for use in the products of these firms.

From the standpoint of promoting investment in underdeveloped regions, more incentives were provided for firms locating their operations in areas requiring development, and development suited to the needs of the people living in these areas was emphasized.

Since January 1983 (BOI Announcement No. 1), four investment promotion regions have been designated in Thailand. After several reevaluations, three such regions were specified in September 1988 (and implemented in January 1989). Under this program, the period of exemption from corporate taxes is lengthened in proportion to the lack of development in the area, while at the same time incentives are offered to parts manufacturers for the selective attraction of foreign investment.

The three specified regions will be described below.

The first consists of six provinces, including Bangkok, and in principle no corporate tax exemptions are granted. However, export-oriented firms (i.e., firms exporting at least 80% of production) and parts manufacturers locating their operations in an industrial park are exempted from corporate taxes for a maximum of three years.

The second region consists of ten provinces, including Ayutthaya, and three-year exemptions from corporate tax are granted. Firms meeting the following special conditions, however, are eligible for an extension of one year for each condition up to a maximum of five years: (1) firms with annual foreign currency earnings of at least US$2 million; (2) firms with local content ratio of at least 60% for agricultural produce and other domestic natural resources (including components); (3) firms producing engineering products; and (4) firms locating their operations in industrial parks. All companies receive an automatic 50% reduction in import duties on machinery, while the following types of companies are exempted entirely from such duties: (1) export-oriented firms; (2) firms utilizing agricultural produce and other domestic natural resources; (3) engineering firms; and (4) firms locating in industrial parks.

The third region consists of 57 provinces, and incentive criteria remain virtually unchanged.

Concerning improvements in related organizations, the Committee on Acceleration of Investment was established in September 1986, and in November the Japanese Investment Desk was established within the BOI.

In contrast to these selective incentives based on performance criteria, a trend towards the reduction of existing incentives is also emerging. In April 1988 it was decided to halt development of industrial parks in the Bangkok metropolitan area and to eliminate incentives for furniture and glove manufacturers in the same area. Furthermore, starting in June 1988 foreign affiliate companies with a foreign capital ratio of 40% or more (excluding BOI-approved firms) became subject to restrictions on land purchases.

In the area of liberalization measures, February 1989 saw the elimination of a ban on the establishment of foreign bank branch offices, and in May 1990 a transition to Article 8 nation of IMF was announced. At the same time, a partial relaxation of restrictions on foreign exchange and capital transactions was announced, and a policy of gradual liberalization is being adopted.

The future outlook appears to hold an emphasis on the nurturing of subcontracting-related firms and the development of ports, industrial land, and other facets of the infrastructure which are fast approaching their limits with the recent boom in foreign investment. Also under examination is the reorganization of the Ministry of Industry.

[Malaysia]

During 1985 Malaysia experienced a serious drop in private investment as a result of poor export performance and falling domestic demand. At the time, investors were uncertain whether the government intended to continuously and aggressively promote the introduction of foreign capital or whether it would concentrate on emergency measures such as restrictions on foreign borrowing. Foreign investment in Malaysia thus dropped significantly during this period.

Moreover, foreign affiliates established in the early 1970s as part the second major wave of foreign investment had lost their eligibility for tax holidays and were hard-pressed to deal with rising labor costs. Taking all of these factors into account, the government hatched a series of clearly-defined measures indicating a transition to the flexible management of Bumiputra policy, namely, the Industrial Master Plan (1986-95) announced in February 1986 and the 1986 Investment Promotion Act. Strong incentives were given to export industries, and a mid-term strategy for the promotion of both local and foreign capital investment was presented. This decision was made with the objective of making an early break from the worldwide recession and in consideration of the aggressive foreign investment attraction measures adopted by the Asian NIEs.

According to the Industrial Master Plan, "Investment incentives must be an integrated part of the industrialization strategy and must encourage private investment in sectors in which Malaysia currently has, or is expected to have in the future, a comparative advantage." Accordingly, proposals such as the creation of incentives for resource-dependent industries, the relaxation of restrictions based on the Industrial Coordination Act, and the promotion of small business were made, and a clear medium-to long-term indicator was given for the industrial promotion sectors.

The main objectives of the 1986 Investment Promotion Act were as follows: (1) the creation of jobs; (2) the promotion of exports; (3) regional development; (4) the effective utilization of natural resources; and (5) the development of technology and manpower. The basic concepts of this legislation were inherited from the Investment Incentive Act of 1968. Later, the main investment-related incentives were specified by the 1986 Investment Promotion Act and the 1967 Income Tax Act.

Concerning export promotion policies, performance criteria based on export ratio and number of employees were established, and firms capable of meeting these criteria were eligible for temporary incentives.

To begin with, in July 1985 a four-step guideline linking allowed foreign capital investment ratios to export ratios was established for new investment in the manufacturing industry. The guidelines were as follows:

(1) When the export ratio is 80% or more, a maximum of 100% foreign investment will be permitted.

(2) When the export ratio is 51%-79%, a maximum of 79% foreign investment will be permitted.
(3) When the export ratio is 20%-50%, a maximum of 51% foreign investment will be permitted.
(4) When the export ratio is less than 20%, a maximum of 30% foreign investment will be permitted.

In September 1986 new guidelines were announced for foreign investment ratios for new investment. These took into account the previously-established four-step guideline and provided for a major relaxation of existing restrictions on foreign investment. In particular, the following types of temporary specifications were indicated, and they succeeded in attracting a rapid influx of foreign capital from the Asian NIEs to Malaysia.

Specifically, concerning investment projects for which applications were made during the period October 1986 - December 1990, (1) those firms exporting at least 50% of production or selling the same amount to an export processing zone or having at least 350 full-time workers would be permitted 100% foreign ownership; and (2) those firms with paid-in foreign capital of at least US$2 million would be automatically allowed to provide posts for five foreigners for the first 10 years of operation, and requests for more posts would be flexibly dealt with. Furthermore, in cases when the field of investment was one of the priority sectors specified by the government, foreign majority ownership of 51% was to be allowed.

In July 1988, restrictions on foreign investment in domestic market-oriented companies, which until then had limited foreign investment to 30%, were revised to permit 100% foreign investment for the first five years of operation, providing that at least 20% of production was exported. Under this plan, however, 49% of ownership, including 30% Bumiputra investment, had to be faded away to the Malaysian side after expiration of the initial five-year period.

In March 1989 incentives were announced for the attraction of operational headquarters. These included: (1) the adoption of a preferential tax rate (10%) on management fees, interest, royalties, and dividends; and (2) non-tax incentives such as permitting posts for more than five foreigners. In February of the same year, incentives were extended to the expansion of operations by existing companies with pioneer status. Many of the pioneer firms whose pioneer status had expired had established subsidiaries for the expansion of existing operations or the commencement of new ones. Under this revision, the same product manufacturing incentives received by the existing firms were passed on to their subsidiaries as well.

Unlike the case of Thailand, no incentives for the development of underdeveloped regions were introduced as part of the operational headquarters attraction measures, the single exception being tax incentives in specified districts.

In order to support these export promotion measures, the Malaysian government is now working to simplify and speed up the relevant procedures. In 1987, the application procedures for incentives, manufacturing licenses, and technical tie-ups were speeded up, and the means of applying for pioneer status were simplified. Furthermore, the functions of the Coordination Center for Investment of the Maalaysian Industrial Development Authority (MIDA) were reinforced in September 1988, and the application and certification procedures required at the federal level for manufacturing industries were integrated. The New Economic Policy in force since 1971 will expire in 1990, but improvements in the investment environment -- enhancement of the infrastructure, provision of financing for small business, and manpower training -- are being continued.

Table II-3-2: Foreign Investment in Asia (1987-89)

	1987		1988		1989	
	Value	Growth over previous year (%)	Value	Growth over previous year (%)	Value	Growth over previous year (%)
R. Korea (millions of dollars)	1,060.2	199.7	1,282.7	21.0	1,090.3	Δ15.0
Taiwan (millions of dollars)	1,418.8	84.2	1,182.5	Δ12.7	2,418.3	104.5
Singapore (millions of Singapore dollars)	1,448.0	21.7	1,657.8	14.5	1,625.4	Δ1.2
Malaysia (millions of ringgit)	750	43.0	2,010.5	168.1	3,372.7	67.8
Thailand (millions of baht)	50,063	359.6	156,419	212.4	205,226	31.2
Philippines (millions of pesos)	3,427	114.1	9,523	177.9	17,481	83.6
Indonesia (millions of dollars)	1,484	79.7	4,408	197.0	4,718	7.0
China (millions of dollars)	3,708.8	30.9	5,297.1	42.8	5,396.0	1.8

Source: Compiled from foreign investment statistics

(4) Trends of Foreign Investment in the Philippines

Foreign investment in the Philippines according to BOI-approved statistics is shown in the following Table.

After bottoming out in 1986, foreign investment approval entered a period of rapid growth, increasing at an annual pace of two- to three-fold during the period from 1987 to 1989. This is reflected in both the number of projects approved by the BOI and the scale of the projects.

Table II-3-3: BOI Approved Foreign Investment

	1986	1987	1988	1989	1989 (Jan-Jun)	1990 (Jan-Jun)
Number of projects	501	1,432	1,337	2,504	1,186	1,432
Project cost (billions of pesos)	3.18	9.84	30.97	70.78	44.5	48.7
(annual target)	—	—	(20.00)	(60.00)	(30.00)	(40.00)
Cost/project (millions of pesos)	6.4	6.9	23.2	28.2	37.6	34.0
Direct job creation (thousands)	26.2	82.1	127.9	184.4	92.2	71.5
Approved investment (equity base in billions of pesos)	3.147	8.359	16.944	39.684	23.122	26.815
Filipino	1.553	4.932	7.421	22.203	13.367	13.074
Foreign	1.594	3.427	9.523	17.481	9.755	13.741

Source: BOI

During January-June 1990, new BOI-approved investment in the Philippines (based on project cost) totaled 48.7 billion pesos. This represents a 10 percent increase over the same period in the previous year, and the effects of the attempted coup d'etat in December 1988 have yet to reflect themselves in the statistics. The investment attraction targets for 1988 and 1989 were 20 billion pesos and 43 billion pesos (revised to 60 billion pesos mid-year), while for 1990 the figure was set at 80 billion pesos. As of the end of June 1990, the BOI had no plans to revise this target.

Concerning the equity base for foreign investment, 13.7 billion pesos of foreign investment was approved during the period January-June 1990, an increase of 40 percent over the previous year. During 1987-90 the ratio of foreign to Filipino capital remained steady at roughly 50 percent, with local capital representing a slight majority in 1987 and again in 1989. In the first half of 1990, Filipino capital accounted for 49 percent of total investment against 51 percent for foreign capital. The cumulative average for 1986-90 was: Filipino, 52 percent; foreign, 48 percent.

Table II-3-4: Foreign Investment in the Philippines

(Equity base; millions of pesos)

	1983	1984	1985	1986	1987	1988	1989	1989 (Jan-Jun)	1990 (Jan-Jun)
Japan	56	568	485	454	591	2,015	3,428	1,918	5,104
U.S.	2,029	1,709	1,087	458	740	3,229	2,852	504	814
Taiwan	5	13	13	7	186	2,317	3,232	2,644	3,200
Hong Kong	48	168	63	149	570	566	2,886	1,729	781
China	18	43	112	38	169	556	740	496	N.A.
U.K.	60	34	355	135	210	485	308	149	N.A.
Other	762	1,366	335	353	961	746	N.A.	2,315	N.A.
Foreign capital total	2,978	3,901	2,450	1,594	3,427	9,982	17,481	9,755	13,740
Filipino capital total	2,239	2,214	2,251	1,553	4,932	7,421	22,203	13,367	13,074

Source: Compiled from BOI statistics

(5) Evaluation of the Filipino Investment Climate by Japanese Corporations

As indicated in the preface, one of the tasks of this survey team involved distributing a questionnaire to related firms in Japan.

At present, completed questionnaires have been received from 32 metal die firms, 30 furniture manufacturers, and 65 computer software houses.

To take the example of the metal die firms, many of the companies expressed a desire to study future investment in the Philippines, and in general there existed a basic interest concerning investment in the Philippines.

Table II-3-5: Destination for Asian Investment (taken from the ASEAN section of Question 4)

	Thailand	Malaysia	Philippines	Singapore	Indonesia
Total	3	2	5	2	2
Metal die manufacturers	2	2	3	1	1
Metal die users	1	—	2	1	1
Number of employees					
Less than 50	—	—	1	—	—
50-299	2	2	3	—	1
300 or more	1	—	—	1	1

In February 1990 a group of foreign corporations (including Japanese companies) with operations in the Philippines submitted a 14-page report concerning legislation having an impact on local and foreign investment in the Philippines to a Joint Senate House Committee. The report was submitted under the names of five foreign chambers of commerce.

The main suggestions outlined included the following: (1) relaxation of the 60:40 investment ratio restrictions; (2) revision of the condominium law to allow foreign-affiliate companies to own factory space; (3) an increase in the leasing period for factory space from the current 25 years to 99 years; and (4) adoption of negative list.

Concerning the above-described measures discussed in the Senate, the foreign chambers of commerce also submitted a series of reports during June-July 1990, and policy-making discussions between the public and private sectors are expected to take on increasing importance in the coming years.

(6) Proposals for Investment Policy

With respect to measures to promote the introduction of foreign capital in the Philippines in the future, we propose the following :

First is the timing of policy decisions. The fact that these bills are being considered during the period from the end of 1990 through 1991 is closely tied to the fact that such policy-related discussions are a precondition for the international financial assistance urgently needed by the Philippines. Another pertinent factor is the increasing concerns being expressed by foreign investors in the Philippines since the second half of 1988.

The second point relates to the ultimate method for the optimum paring of incentives. This problem involves a demand for reevaluation of government programs due to budgetary restraints, and it is an economic matter which cannot be ignored. At the same time, however, some argue that the incentives should actually be expanded. Debate on this issue has intensified during the latter half of 1990. It would be more effective from the standpoint of industrial options, however, to reevaluate programs in a selective fashion rather than simply cutting incentives across the board.

The third point is that demands are being made for the enhancement of functions at the various working units of the BOI and other government organizations responsible for the selective introduction and management of foreign investment. Criteria for performance and degree of contribution, such as the promotion of exports and the creation of jobs, should be continually monitored. This will also be an effective means of promoting development in individual sectors.

Fourth, it will be important to provide foreign investors with a clear presentation of the final policies.

The current reevaluation of programs can be described as one link in the structural realignment efforts. Some of the items up for discussion will have an extremely wide-ranging impact on the Philippine economy and society -- incentives, taxation, foreign ownership of industrial property, etc.

One example is the Condominium Law (Republic Act No. 4726), for which a request for revision has been made by the representatives of numerous foreign chambers of commerce in Manila. Debate is proceeding in the direction of loosening current restrictions, and it is thought that the final decision will be closely related to the outcome of the negative list described above. Should the relaxation of restrictions proceed as hoped, the BOI is preparing to present a package program consisting of the new restrictions, revisions to the National Internal Revenue Code, and a program for net loss carry-over and appreciated depreciation.

In this sense, a clearer policy decision and international presentation are hoped for. In any case, 1990-91 will be an extremely important time for government policymaking in the Philippines.

Table II-3-6 : Major Revisions in the Foreign Investment Attraction Policies of Asian Countries/Regions

	Republic of Korea	Taiwan	Thailand	Malaysia	Indonesia
Minimum investment criteria	• The minimum allowed foreign investment is $100,000. • In the case of joint small-scale investment, the figure is reduced to $50,000 provided there is a transfer of technology. (General Guidelines for Foreign Direct Investment, Clause 3)	• Due in part to the important role played by small business investment in the past, there are no restrictions on foreign investment. • Concerning the lease industry, paid-in capital of at least NT$100 million is required, and the percentage of foreign capital must be 50% or less.	• The minimum investment (excluding land costs and operating funds) is lowered from 5 million bahts to 1 million bahts (October 1986).	• Manufacturers with capital of less than M$2.5 million and fewer than 75 full-time workers are exempted from all restrictions, including those on foreign investment ratio (October 1986).	• The minimum foreign investment for PMA (foreign affiliate) companies is lowered from $1 million to $250,000 (May 1989), but small-scale investment will be examined in consideration of the following elements: (1) creation of jobs; (2) export of non-petroleum gas products; and (3) expansion of supporting industries for large corporations.
Relaxation of restrictions on foreign investment ratio (related liberalization measures)	• Applications will be approved without further examination provided the following four conditions can be met: (1) the field of business is not one in which foreign investment is prohibited or restricted under the negative list; (2) the foreign investment ratio is less than 50%; (3) the firm receives no reduction or exemption from local taxes; and (4) the amount of foreign investment is less than $5 million. • In principle there are no restrictions on foreign investment ratio for approved industry sectors. Investment in restricted sectors requires individual examination and approval. • The revised General Guidelines for Foreign Direct Investment (July 1989) extends the manufacturing sectors in which	• Administrative directives limit foreign investment to 49% outside export processing zones, but there have been moves towards relaxation of this clause. • The maximum permitted inward remittance was raised from US$1 million to US$2 million (July 1990). • Previous guidelines linked to export ratio restrictions are scrapped (the auto industry is the first case) (March 1987). • Restrictions on the establishment of foreign bank branch offices and permanent offices are revised and the criteria for certification relaxed.	• Although there are no restrictions on foreign investment ratio, the Alien Business Law (November 1972) provides restrictions on majority foreign ownership based on Categories A, B, and C. • For joint ventures, the guidelines and criteria for tax-related incentives are as follows: (1) when the company is domestic market-oriented, the ratio of foreign investment must be 49% or less; (2) in the case of agriculture, fisheries, and service industries, the maximum allowed investment ratio is 40%; and (3) when the export ratio is at least 50%, foreign investment of 50% or more is permitted, and when all production is exported, 100% foreign ownership is allowed. • The prohibition on the establishment of foreign	• When the company is domestic market-oriented, the ratio of foreign investment must be 49% or less. • 100% foreign ownership is allowed for projects involving the extraction and temporary processing of non-recyclable natural resources. • 100% foreign ownership is permitted for export-oriented manufacturers. • In the case of new investment in the manufacturing industry, a four-step guideline linking foreign investment ratio and product export ratio is established (July 1985). • Restrictions on manufacturing licenses are once again relaxed (October 1986). • The Revised Investment Promotion Act provides for the expansion of tax-related investment incentives (December 1986).	• When a PMA (foreign affiliate) company is established, the foreign investment ratio must be less than 80%. • The foreign investment ratio may be as high as 95% in any of the following cases: (1) when at least 65% of production is exported; (2) when the investment is made in a specified underdeveloped district; or (3) when total investment is at least $10 million. • Foreign affiliates are to receive the same treatment as local companies (under certain conditions) (May 1986). • Import duties are lowered, portions of the designated importer system are scrapped (October 1986). • Export sectors are opened to foreign investment (May 1987). • The management of indus-

	Republic of Korea	Taiwan	Thailand	Malaysia	Indonesia
	foreign investment was allowed and establishes a certification board for foreign investment. * The maximum foreign investment allowed in the manufacturing industry is raised to $100 million (January 1990). For approved industry sectors, there are in principle no restrictions on foreign investment ratio.		bank branch offices is lifted (February 1989).	• Restrictions on foreign investment ratio are relaxed. Domestic sales portion is expanded (July 1988). • The following incentives are established for the attraction of operational headquarters. (1) A preferential tax rate (10%) is adopted for income stemming from management fees, interest, and royalties. Also, a ten-year tax holiday is instituted for dividends received from subsidiaries or affiliates of operational headquarters established after implementation of the current incentives. (2) Non-tax incentives, such as the approval of more than five posts for foreigners, are established (March 1989).	trial parks is opened to foreign investment (for an initial period of 30 years, capable of being extended for another 20 years) (October 1988).
Negative list	• Foreign Capital Inducement Act of July 1984 negative list were adopted. As a result, the introduction of foreign investment is now allowed in 726 out of 999 industry sectors. • Relaxation of the restricted sectors for foreign investment. Liberalization ratios: 76.3%, 78.9% (August 1987), 79.2% (June 1990).	• A liberalization ratio of 73.2% (May 1988). • Preparation of Negative List for Investment by Overseas Chinese and Foreign Nationals. The liberalization ratio is 86% for foreign nationals and 87.5% for overseas Chinese (May 1988). • Revision of the Statute for Investment by Foreign Nationals and Overseas Chinese, adoption of a system of negative list for investment (May 1989). • Revision of the Negative List for Investment by Overseas Chinese and For-	• (1) Category A (foreign majority ownership prohibited) 13 sectors; (2) Category B (foreign majority ownership permitted providing certain conditions are met; in cases when the given project is to receive BOI investment incentives) 36 sectors; (3) Category C (advance approval of the Ministry of Commerce required) 13 sectors. (Alien Business Law No. 281) (December 1972)	• There are no restrictions on legal foreign investment. Foreign investment in public utilities (including the press) was difficult in the past, but privatization policies make ownership of up to 30% possible.	• The Investment Priority List (DSP) is replaced by the Investment Negative List (DNI) (May 1989). Based on the list, 75 sectors are closed to foreign investment. 20 of these are closed only to foreign investment, and the remaining 55 are closed to any type of new investment. The minimum investment amount is lowered to $250,000.

	Republic of Korea	Taiwan	Thailand	Malaysia	Indonesia
		eign Nationals. The liberalization ratio is 86.2% for foreign nationals and 89% for overseas Chinese (July 1990).			
Incentives based on contribution to exports	* Many incentives are scrapped, forcing foreign affiliates to compete under the same conditions as local firms. * The Revised Foreign Investment Law (July 1988) provides in principle for the elimination of tax incentives for foreign companies with an export ratio of at least 50%.	• Restrictions on export ratios (for automobiles in particular) are scrapped (March 1987). • Basic policy is shifted to general incentives for production activities and strategic industries rather than exports themselves.	• Foreign investment of at least 50% is allowed with an export ratio of at least 50%; if all production is exported, 100% foreign ownership is permitted. (The required export ratio is lowered from 80% to 50% for the first two years of operation.) (October 1986)	• Firms with an export ratio of at least 50% and employing at least 350 full-time workers are permitted 100% foreign ownership. (Valid for applications made through December 1990) (October 1986) • The corporate tax holiday for export corporations is extended from five to ten years. Incentives for reinvestment are also extended (November 1987). • Incentives are extended to cover the expansion of operations by existing companies with pioneer status (February\ 1989).	• Export corporations are defined as those firms with an export ratio of at least 65%; when establishing a PMA (foreign affiliate) company foreign investment of up to 95% is possible (1987). • The Investment Negative List is partially opened, based on export ratios (two categories: 65% and 100%).
Incentives for research and development outlays	• A 15-year tax exemption/reduction is offered on royalties stemming from the introduction of sophisticated technologies (65 sectors in 8 industries). * There are plans for reducing the above-mentioned tax exemption/reduction for royalties.	• Tax credits are given for R&D fees provided certain conditions are met (Statute for Encouragement of Investment). • The Statute for Investment by Foreign Nationals and Overseas Chinese and the Statute for Technical Cooperation are revised (March 1989). Investment of less than $1 million may be reported after the fact.	• Royalties are exempt from taxation for five years.	• The tax rate on royalties is reduced to 10% for a period of 5-10 years (March 1989). • (1) Costs for scientific research leading to future income are eligible for deductions. Costs for research approved by the Minister of Finance are eligible for double deductions. (2) A portion of the costs of constructing buildings to be used for research may be deducted. (3) Investment in plants and machinery to be used in research is eligible for	• Research and development by the Agencies for Study and Technology Development. • Taxes on royalties are to be lowered based on a tax accord.

	Republic of Korea	Taiwan	Thailand	Malaysia	Indonesia
				capital deduction. • Incentives are provided for training. • Corporate taxes are lowered, and the development tax is to be gradually phased out (October 1988).	
Guidelines for land acquisition (plant site ownership)	• Land acquisition is allowed, but permission is required when the foreign investment ratio exceeds 50%.	• Land acquisition is permitted in the manufacturing industry, provided that the project is approved by the Investment Commission, Ministry of Economic Affairs. • The utilization of industrial property has long been closely monitored. Utilization must begin within one year after the purchase. • Starting in 1987 there was a move to permit the partial resale of industrial property.	• The ownership of property to be used for incentive industry activities is permitted (Investment Promotion Act, Clause 27). Foreign ownership exceeding 49% is also possible. * Land acquisition by foreign affiliates (excluding BOI-approved enterprises) with a foreign investment ratio of 40% or more is restricted (June 1988).	• Companies designated as operational headquarters are permitted to acquire fixed assets as part of their corporate activities (March 1989).	• Companies may acquire the right to use land. The right of ownership is limited to Indonesian citizens. • Conditions requiring the localization of capital are relaxed (May 1987).
Regional development criteria (incentives for investment in underdeveloped regions) (classification and reevaluation of regional investment incentive)	• Firms locating their operations in government-specified industrial development promotion regions and industrial attraction regions outside the major cities are eligible for reduced corporate and property tax rates.	• Foreign investment is to be attracted in four types of regions across the Taiwan: developed industrial estates, developing industrial estates, export processing zones, and science-based industrial parks.	• A reevaluation of the investment promotion regions and incentive measures is conducted (starting in September 1988 and January 1989), and three regions are specified: the first consisting of 6 provinces, the second of 10, and the third of 57. * The incentives for industrial park development and furniture and glove manufacturers in the Bangkok metropolitan area are eliminated (April 1988).	• 84 industrial promotion districts are specified around the country, and companies locating operations in these districts are eligible for a 5% income tax deduction or ITA tax deductions.	• In cases of foreign investment in outlying districts (10 provinces specified), up to 95% foreign investment is allowed when establishing a PMA company (i.e., a foreign affiliate) (1987).

Note: Measures marked with a * indicate a tightening or cutback of existing incentive policies.

3-2 Trade Policy

(1) Vision for Economic Development

According to a vision ("Development and Industrialization: Our Vision") laid out by the policy division of the Department of Trade and Industry (DTI) in October 1989, it is hoped that the Philippines will build up an industrial base which will allow the country to attain NIEs status by 2000 and to lower its poverty level to 10-15 percent (49 percent as of 1988) of the population.

According to the vision, the real growth rate of the GNP will maintain an annual average of 9.5-10 percent during the 1990s. Per capita GNP is seen rising to $1,500 in 2000 (the government estimate stands at $769 as of 1989), and the value of exports for that year will increase to $35 billion.

The government envisions the agricultural sector, with its current low productivity, being reorganized into an agro-industry. This is because the area under cultivation by Philippine farmers averages a mere 0.51 hectares per farmer(as of 1988), half the amount under cultivation by their Indonesian or Malaysian counterparts. Moreover, due to the pressure of the increasing population, unemployed people who are absorbed into farming villages are being forced to cultivate marginal tracts of land in the mountains, marshlands and sandy areas, further lowering productivity in the agricultural sector.

(2) Response to Economic Growth

The Aquino administration, which has held power since the fall of the Marcos administration in the civil revolution of February 1986, realized plus economic growth of 1.5 percent in 1986 after two straight years of minus growth in 1984 and 1985, placing the Philippine economy on the road to recovery.

In 1987, the government established its medium term development plan (1987 to 1992), where it devised positive economic measures aimed at achieving an average annual economic growth of 6.4 percent. In 1987, the Philippines achieved a real GNP growth rate of 5.7 percent and in 1988 that of 6.7 percent.

Economic activity continued to expand in 1989 and increased investment activity from overseas was seen, but economic activity stagnated immediately after the December attempted coup d'etat and the growth rate remained in the 5 percent range.

In 1990, it was not until after the first quarter that the Philippines recovered from the turmoil and stagnation caused by the failed coup. In the first half of the year (January to June), the real GNP growth rate returned to the 5 percent level. The major earthquakes in mid July and the soaring price of crude oil due to the Iraqi invasion of Kuwait in August, however, struck a massive blow to the Philippine economy, which depends on imported crude oil to a large extent for its energy, resulting in double-digit inflation. Labor unrest and demands for hikes in the minimum wage continued, remarkably slowing economic activity. Some forecasts even saw a minimum zero or minus growth in the GNP in the second half of the year.

To cope with these negative factors and encourage economic growth, the government authorities are forcing ahead with restraints on interest rate increases, the cultivation of industrial competitiveness, gradual liberalization of imports and improvement of infrastructure. They are reforming the economy to build up an economic structure in which commercial activities are liberalized and the principle of market competition works.

In particular, as 1991 drew near, the government pushed forward with plans to eliminate unnecessary competition inside and outside the country in an attempt to improve the country's market economy, for example, devising measures to restrict smuggling and prevent dumping.

The government would also like to disperse industry to areas other than Metro Manila. In this regard, it hopes that the Calabar Special Development Project and the like will become models for development. Further, regarding extension of credit to the private sector, the government is working to increase the extension of credit, first and foremost operating funds, to enable rehabilitation and modernization and augmentation of facilities and has expressed an intention of seeking help from the World Bank, the ASEAN-Japan Development Fund, etc.

Table II-3-7: Trends in Balance of External Debt of the Philippines

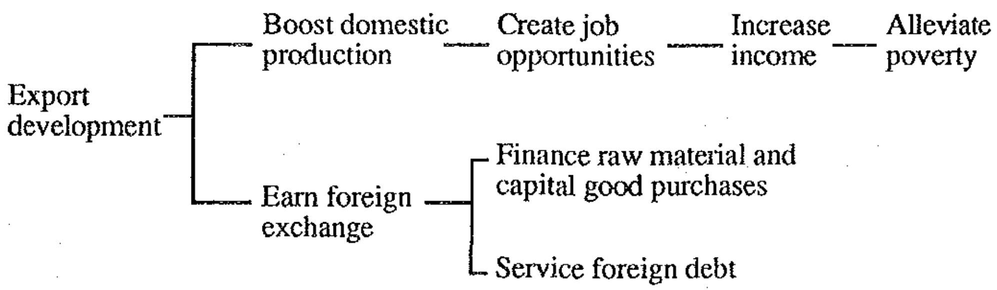
(Unit: $ million, %)

	Total	Ratio of debt to exports(%)	Ratio of debt to GNP(%)
1980	17,422	212.4	49.5
1985	26,643	331.9	43.1
1986	28,330	322.1	64.0
1987	30,052	320.2	68.0
1988	29,448	266.1	58.1

Source: World Bank, World Debt Table, Vol.2, 1989-90

(3) Direction of Trade Promotion

The basic posture of the DTI regarding export promotion is that exports should be developed as a chief means of economic growth with the aims of eliminating poverty and repaying cumulative external debts.



The realization of export growth begins from the cultivation of international competitiveness in the manufacturing sector. The government's economic and social policies will greatly influence this.

Convening the country's first National Export Conference in May 1989, the government unveiled a "National Export Strategy, 1989-92," stressing the importance of trade promotion.

The government envisions that export promotion will bring about: [1] the creation of additional job opportunities, [2] the stimulation of industrial dispersion to the provinces, [3] the development and improvement of appropriate technology and [4] increases in government revenues.

The export strategy of the government includes the following:

1. A high purchasing ratio of domestically-produced raw materials.
2. Production in regions outside the National Capital Region.
3. A high degree of linkage with other types of industry and production items.
4. Promotion of direct exports from provinces (central and southern Luzon, central Visaya, Leyte, Samar and northern Mindanao).

Under the above export strategy, the DTI desires to promote the development of (1) GSP (Generalized System of Preference) eligible products and (2) export oriented products in the field of light industrial products. It lists the following products as falling under these categories:

1. Garments and textiles
2. Semiconductors and electronics
3. Processed food and beverage
4. Furniture and wood products
5. Ceramics
6. Gifts and housewares
7. Computer services
8. Metal products and machinery
9. Marine and aquaculture

Further, it mentions the following agricultural products and processed agricultural products as for promotion:

1. Oleo chemicals
2. Rootcrops and nuts
3. Cereals
4. Mushrooms, asparagus, tomatos
5. Spices
6. Cacao
7. Coconuts and coconut coir
8. Bananas

The Philippine government holds that exports should be developed to the maximum degree through the efforts of private enterprises. It thinks that unjust intervention by the government and its agencies will deter the vitality of private enterprise. It goes without saying that the state's export plans, if they are to succeed, require a strong partnership between the government and the private sector.

1) Export Development Bill

The government mobilized representatives of the private trade sector in the first half of 1990 through the Bureau of Export Trade Promotion (BETP) to reevaluate the state of export promotion and put together the draft Philippine Export Development Bill of 1990 by the end of July 1990. This Bill had already been submitted to the Congress in November 1990, but the deliberations over it had still not ended then and there was reportedly a good chance that it would be carried over to the first quarter of 1991. Whatever the case, if the draft Bill is made act, the, related parties hope, the trade promotion programs of the government will be spurred further on.

The main points of the bill are to strengthen the state's responsibility for planning and adjusting export policies and to create a new export development fund aimed at promoting exports by utilizing the vitality of private enterprise.

A trade council comprising representatives of the government and the private sector will be formed to draw up National Export Development Programs. A new nonprofit body called the Philippine Export Development Organization will be set up and collect 0.25 percent of the value of exports-imports for its funds. The funds will be disbursed to support the following:

1. Contributions to help realize product exports.
2. Feasibility studies.
3. Servicing trade inquiries.
4. Assistance in displaying products at international exhibitions and trade fairs.

In setting up the new body, the two existing organizations, the Philippine Exporters Foundation Inc. and the Confederation of Philippine Exporters Inc., will be dissolved and their assets and personnel will be transferred to the new body.

2) The Trade Imbalance

Five years after the birth of the Aquino government, the strain of its export-import policy is enhancing the trade imbalance, causing the depreciation of the peso.

Looking at exports, exports totaled $7 billion in 1988, 23 percent higher than the previous peak $5.7 billion of 1980. Further, the Philippines recorded a new historical high of $7.82 billion in 1989. This was largely due to the increase in exports of non-traditional items in the total value of exports.

In 1980, exports centered on traditional items such as coconut products, sugar, logs, copper ore, fruits and vegetables, fish and shellfish, etc. These accounted for 53 percent of total export value. Industrial products, which typify non-traditional items, accounted for a low 35 percent. In the middle of the 1980s, exports of industrial goods exceeded those of traditional items. By 1987, the share of non-traditional items had risen to 73.4 percent, by 1988 to 75.8 percent, and by 1989 to around 80 percent.

On the other hand, imports totaled $8,159 million in 1988, 2.6 percent higher than the peak $7,950 million of 1981. In 1989, the Philippines recorded a new historical high of $10.4 billion. The reasons behind the increase in imports were the increased imports of capital goods such as power generators and communications equipment for building up the infrastructure, increased imports of construction related materials, crude oil, and consumer goods due to deregulation, and further to increased imports of machinery and equipment along with the greater investment.

Although both exports and imports have expanded, the deficit in the trade balance is not likely to be solved easily. This is because any growth in exports has been preceded by the import of raw materials and semifinished products to be used for export goods. Moreover, the demand for imported machinery and equipment due to industrialization continues to rise.

Table II-3-8: External Trade of the Philippines

	Exports ($million)	Exports Compared to previous year (%)	Imports ($million)	Imports Compared to previous year (%)	Balance ($million)
1986	4,841	4.59	5,043	Δ 1.32	Δ 202
1987	5,720	18.14	6,736	33.57	Δ1,016
1988	7,074	23.76	8,159	21.12	Δ1,085
1989	7,820	10.55	10,418	27.68	Δ2,598
1990 (Jan-Oct)	6,743	3.90	10,085	16.30	Δ3,342

Source: DTI
Note: Figures for 1990 (January to October) from NSO.

Table II-3-9: Philippine Merchandize Exports 1986 - May 1990

(FOB Value in Million US$)

Year	Value	% Inc. (Dec.) over previous year	Target (MTPDP)	% Variance favorable (unfavorable)
1986	$4,841.78	4.59%	$4,604.00	5.16%
1987	5,720.24	18.14	4,985.00	14.75
1988	7,074.19	23.67	5,688.00	24.37
1989	7,820.71	10.55	6,490.00	20.51
1990 (Jan-May)	3,263.86	5.20	3,492.00	(6.52)

Source: DTI-BETP, MTPDP (medium term development plan)

For example, an analysis of imports in 1988-89 shows that raw materials and semifinished products accounted for 54 percent of the total imports in 1988 and 52 percent in 1989 and that imports of these items are increasing at an annual average of 30 percent.

Out of the aggregate of imports of raw materials and semifinished products, semifinished products account for as high as 85 percent. Standing out among the statistics is the figure for the growth in imports of textile yarn, fabrics, embroidery, synthetic resins, steel and metal, and nonferrous metals. The import of these items increased to meet the rising demand for raw materials by export-related sectors.

Table II-3-10: Philippine Imports of Raw Materials

(Value in $million)

	1988		1989		Compared to previous year(%)
Unprocessed raw materials	624.40	14.14	804.76	14.94	28.88
Wheat	135.96	3.08	195.24	3.62	43.60
Inedible	413.55	9.37	528.30	9.81	27.75
Other	74.89	1.69	81.22	1.51	8.45
Semi-processed raw materials	3,791.21	85.86	4,581.55	85.06	20.85
Chemical compounds	367.11	8.31	410.20	7.62	11.74
Medicinal & pharmaceutical chemicals	113.28	2.57	123.18	2.29	8.74
Artificial resins	229.99	5.21	288.88	5.36	25.61
Other chemicals	328.69	7.44	392.97	7.30	19.56
Paper and pulp	111.28	2.52	131.19	2.44	17.89
Textile yarn and fabrics	324.00	7.34	452.65	8.40	39.71
Iron and steel	475.20	10.76	743.23	13.80	56.40
Nonferrous metals	123.95	2.81	174.01	3.23	40.39
Metal products	84.90	1.92	116.34	2.16	37.01
Embroideries	376.70	8.53	436.42	8.10	15.85
Materials and accessories for the manufacture of electronic equipment	910.06	20.61	884.56	16.42	Δ 2.80
Others	346.05	7.84	427.92	7.94	23.66
Total	4,415.61	100.00	5,386.31	100.00	21.98
Percentage to aggregate exports	54.12		51.70		

Source: DTI

On the other hand, in exports, note should be taken of the fact that the growth rate declined after peaking at 24 percent in 1988.

Some trade experts are of the opinion that this is because the number of types of exportable products and their supply have approached the marginal capacity. At any rate, export promotion in the future will require the development of exportable products and the strengthening of the system for their supply.

Looking at the exports of the Philippines by key countries and regions, the U.S. and Japan have accounted for close to 60 percent of the total value of exports. This trend is continuing.

Looking at industrial products for the U.S., there has been growth in exports of garments, primarily, and in furniture, fashion accessories, and electronic equipment made by Japanese-affiliated companies. In the first half of 1990, the reliance on the U.S. rose even further.

Exports of shrimp and primary products to Japan have been stagnating due to the deterioration of the markets, but there has been growth in copper products and electronic components and exports increased gradually as a whole. However, looking at imports from Japan, there was growth in demand for imports of capital goods and components, with the result that Japan pulled ahead of the U.S. in 1989 to become the number one country of origin.

On the other hand, trade within the ASEAN countries has been growing. Exports to the Asian NIEs have been slow in growing, but the Asian NIEs have risen in position as countries of origin of imports of materials and components for electronic products and garments.

In addition, exports to the EC have been increasing, but conversely there has been marked growth in imports from West Germany and the U.K.

Table II-3-11: Exports of the Philippines by Key Countries and Regions

(Unit: $ million, %)

	1987		1988		1989	
	Value	Share	Value	Share	Value	Share
U.S.	2,064	36.0	2,516	35.5	2,946	37.6
Japan	981	17.2	1,420	20.1	1,586	20.3
EC	1,089	19.0	1,212	17.1	1,327	17.0
Middle and Near East	101	1.8	100	1.4	123	1.6
ASEAN	507	8.9	492	7.0	532	6.8
Socialist countries	116	2.0	91	1.3	76	1.0
Others	862	15.1	1,243	17.6	1,231	15.7
Total	5,720	100.0	7,074	100.0	7,821	100.0

Source: NEDA

3) Actual Situation of Exporting Enterprises

There are 5,267 export-related enterprises in the Philippines (according to a DTI survey as of 1987), most of which are micro, cottage, small and medium-size firms lacking financing.

For instance, the annual sales of 62 percent of the firms are $100,000 or lower. Firms with annual sales of $500,000 or less account for 81.5 percent of the total. Their total sales account for a mere 5.6 percent of aggregate exports.

On the other hand, firms with annual sales of $5 million or more (194 firms in the survey), amounting to 3.6 percent of the total number of firms, account for 72.8 percent of the total value of exports.

Large differences exist between the export-related enterprises in the Philippines. Small and medium-size firms are constrained not only by a lack of finances. They are also generally lacking in expertise and know-how regarding trade and their marketing information and quality control are insufficient.

Because of this situation, the Bureau of Small and Medium Business Development (BSMBD), in its measures for the promotion of small and medium-size enterprises,