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

SECOND YEAR FINAL REPORT

June 1992

Japan International Cooperation Agency (JICA)

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PREFACE

In response to a request from the Government of the Republic of the Philippines, the Government of Japan decided to conduct a 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, two times between June 1991 and November 1991.

The team held discussions with the officials concerned of the Government of the Philippines, and conducted field studies. 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.

June, 1992

Kensuke Yanagiya

Kensuke Yanagiya
President
Japan International Cooperation Agency

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Abbreviations

ADB	Asian Development Bank
AE	Alkyl Ether
AES	Alkyl Ether Sulfate
AOMG	ASEAN Oleochmical Manufacturers Group
APG	Alkylpolyglucoside
AS	Alkyl Sulfate
BETP	Bureau of Export Trade Promotion
BITR	Bureau of International Trade Relations
BPS	Bureau of Product Standards
BOD	Biochemical Oxygen Demand
BOI	Board of Investments
BOI	Board of Investment (Thailand)
BSMBD	Bureau of Small and Medium Business Development
CALABARZON	Cavite, Laguna, Batangas, Rizar and Quezon
CCPI	Coco Chemical Philippines, Inc.
CCSF	Coconut Consumers Stabilization Fund
CEBU-FAME	Cebu Fashion Accessories Manufacturers and Exporters, Inc.
CIB	Credit Information Bureau
CISF	Coconut Industry Stabilization Fund
CITEM	Center for International Trade Expositions and Missions, Inc.
CMD	Chemicals and Minerals Department (of the ITDI)
COCOFED	Philippine Coconut Producers Federation
COPE	Confederation of Philippine Exporters, Inc.
CPSC	Consumer Product Safety Commission (U.S.)
DA	Department of Agriculture
D/A	Documents against Acceptance
DAR	Department of Agrarian Reform
DENR	Department of Environment and Natural Resources
DEP	Department of Export Promotion (Thailand)
DOLE	Department of Labor and Employment
DOP	Dioctyl Phthalate
DOST	Department of Science and Technology
DTI	Department of Trade and Industry
EO	Executive Order
EPZ	Export Processing Zone
EPZA	Export Processing Zone Authority
FAO	Food and Agriculture Orgarization
FAMA-PHIL	Fashion Accessories Manufacturers' Association of the Philipines
F.A.M.E.	Furnishing and Apparel Manufactures Exchange
FCDU	Foreign Currency Deposit Unit
FELCRA	Federal Land Consolidation and Rehabilitation Authority (Malaysia)
FELDA	Federal Land Development Authority (Malaysia)
FOBAP	Foreign Buyers Association of the Philippines
FPRDI	Forest Products Research and Development Institute
GTEB	Garment and Textile Export Board
HAB	Hard Alkylbenzene
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund

IPP	Investment Priorities Plan
ITDI	Industrial Technology Development Institute
JICA	Japan International Cooperation Agency
JETRO	Japan External Trade Organization
KOTRA	Korea Trade Center
LAS	Linear Alkylbenzene Sulfonate
L/C	Letter of Credit
LOI	Letter of Intent
MAI	Multilateral Assistance Initiative
MAP	Mono Alkyl Phoshate
MARDI	Malaysia Agricultural Research and Development Institute
MCT	Midium Chain Triglyceride
MIRDC	Metals Industry Research and Development Center
NEDA	National Economic and Development Authority
NMYC	National Manpower Youth Council
PCA	Philippine Coconut Authority
PCHI	Philippine Chamber of Handicraft Industries, Inc.
PCRDF	Philippine Coconut Research and Development Fund
PDDCP	Product Development and Design Center of the Philippines
PEFI	Philippine Export Foundation, Inc.
PFAD	Palm Fatty Acid Distillate
PHILCIDA	Philippine Coconut Industry Development Authority
PHILTOY	Philippine Toy and Novelty Manufacturers Association, Inc.
PITC	Philippine International Trading Corporation
P/O	Purchase Order
POE	Polyoxyethylene
POMA	Philippine Oleochemical Manufacturers Association
PORDB	Palm Oil Research and Development Board (Malaysia)
PORIM	Palm Oil Research Institute of Malaysia
PORLA	Palm Oil Registration and Licensing Authority (Malaysia)
PTMA	Philippine Toy Manufacturers Association
PTTC	Philippine Trade Training Center
RBD	Refined Bleached Deodorized
RIC	Regional Industrial Center
RISDA	Rubber Industry Smallholders Development Authority (Malaysia)
SBGFC	Small Business Guarantee and Finance Corp.
SCFDP	Small Coconut Farms Development Project
SDAP	Soap and Detergent Association of the Philippines
SEC	Securities and Exchange Commission
STPP	Sodium Tripolyphosphates
TFGH Dept.	Toys, Gifts, Furniture & Houseware Department
TLRC	Technology and Livelihood Resource Center
TMA	Toy Manufacturers of America
UCAP	United Coconut Association of the Philippines, Inc.
UCPB	United Coconut Planters Bank
UNICOM	United Coconut Oil Mills, Inc.

I. Introduction

I. Introduction

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

The surveys were begun in May 1991 on the basis of the Scope of the Study in the Implementing Arrangement 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 May 1992.

1. Survey Background

Economic reconstruction, and particularly the repayment of external debt, 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, and in the following year the country was hit by a volcanic eruption. Thus, the economic performance of the country worsened quickly. It is against this background and only weak signs of economic recovery that the presidential election was held in May, 1992.

Even should there be a change in government, 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 second year:

Toys (Stuffed toys)
Fashion accessories (Costume jewelries)

Oleochemicals

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 draft final report
7) Compilation of the final report

6. Schedule of Surveys

Field survey	June 10 - August 8, 1991
Interim consultations and supplementary surveys	November 16 - November 30, 1991
Draft final consultation	March 10 - March 18, 1992
Domestic questionnaires	June - August 1991
Third country surveys	June - September 1991

In-depth interviews were used for the field surveys. A total of 201 such interviews were made and a total of 307 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	Questionnaires Collected	Remarks
Toys	65	15	76[(b)]	Complete count
Fashion accessories	67	14	231[(c)]	Complete count
Oleochemicals	29	11	Not conducted	

Notes: (a) In-depth interviews were conducted with private companies, a small number of institutions and other organizations.
(b) A total of 120 questionnaires were distributed.
(c) A total of 279 questionnaires were distributed.

Table I-2: Geographical Areas Covered by Field Survey

Sub-sector	Areas Covered
Toys	Metro Manila, Bulacan, Cebu
Fashion accessories	Cebu, Metro Manila, Bulacan
Oleochemicals	Metro Manila, Laguna, Batangas, Lucena, Cagayan de Oro

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.

Toys / Small Enterprises Research and Development Foundation of the Philippines (SERDEF)
Fashion accessories / Cebu Fashion Accessories Manufacturers and Exporters, Inc. (CEBU-FAME)

Table I-3: Details of Questionnaire Survey in Japan

Sub-sector	Companies Covered	No. of Companies	Study Items
Toys	Manufacturers	120	• Issues in management and possibilities for entry into Asia, technological tie-ups, import business
Fashion accessories	Manufacturers	151	• Degree of business interest in Philippines and other Asian countries • Form of import busisness and import programs • Issues involved in business with the Philippines and possibilities of expanding imports
Oleochemicals	Not conducted		

Note: As to oleochemicals, instead of the questionaire, interviews with MITI, major industry organizations, and oil and fat manufacturers (16 interviewees) were conducted.

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

Sub-sector	Export Markets	Competing Countries
Toys	U.S., Germany	R. Korea, Thailand
Fashion accessories	U.S.	Thailand
Oleochemicals	U.S.	Malaysia, Indonesia

7. Members of the JICA Study Team

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/Economist	Mr. Tamaichi MATSUMOTO
Sub-Leader/Economist (Export & Investment Promotion)	Mr. Nobuo KOBAYASHI
Sub-Leader/Economist (Industrial Sector Development)	Mr. Tetsuo INOOKA
Toys-Stuffed Toy	
Export/Investment Promotion Specialist	Mr. Masayuki SWEDA
Industrial Economist	Mr. Hirofumi YMAUCHI
Product Specialist	Mr. Seiichi FUKUSHI
Fashion Accessories-Costume Jewelry	
Export/Investment Promotion Specialist	Ms. Chieko OHGAKI
Industrial Economist	Mr. Yoshinari YAMAMOTO
Product Specialist	Mr. Yasuo MIZUNO
Oleochemicals	
Export/Investment Promotion Specialist	Mr. Atsushi SUZUKI
Industrial Economist	Mr. Hiroshi HASEGAWA
Project Engineer	Mr. Yoshiki HAYASHI
Chemist	Dr. Akio KATO
Market Analysis (Investment Promotion)	Mr. Yutaka MIYAHARA
Market Analysis (Export Promotion)	Mr. Jun TSUNEKAWA
Industrial Association Development	Mr. Yoshio SATO
Finance and Taxation System	Mr. Yasunaga TAKACHIHO

II. Policy Review and Tasks

II. Policy Review and Tasks

1. Industrial Development Policies

(1) Structural Deficits in the Industrial Sector and Its Influence on Sub-Sectors Studied

1) Introduction

In the first year study report, the following was pointed out as an issue on industrial structure in the Philippines observed when Aquino administration was formed.

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 garments 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 of 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.

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.

However, so far, such government effort had little effect on the economic improvement. In addition, the significant increase in wage rates compared to that of the neighboring countries, especially of China, has reduced the advantage in international competitiveness of Philippine industries, which were established taking advantage of cheaper labor costs. Generally speaking, increase in wage rates is a result of increase in demand for labor caused by industrial development. Under such circumstances, the industries usually have to make efforts to develop themselves by strengthening such non-price competitiveness as improved technology, and well-organized material supply ability, etc.

However, in the case of the Philippines, the industrial development is still insufficient. Namely, new industries, which are anticipated to be developed under the new economic order, are not developed well, and the existing inefficient industries have contracted; thus, industrial structure has increasingly become unfavorable for industrial development.

Such symptom is especially seen in the field of raw material supply. Cease of operation of inefficient industries and removal of foreign affiliated firms from Philippines as observed in the various industries, has resulted in decrease in the number of locally supplied industrial products, and increased import reliance of raw material supply. At the same time, it became an impediment factor for expansion of domestic market (or contraction factor in certain areas), since it caused contraction of local demand. Thus, contraction of raw material supply sector is a bottleneck of industrial development in view both of supply and demand.

The backwardness of technology development and obsolete production facilities, especially of SMEs, has resulted in difficulty to formulate linkages with export sectors. The lack of linkage has impeded the effort to absorb increasing costs of labor through subcontracting; resulting in decrease in cost competitiveness.

Delay in development of infrastructure and technical infrastructure has resulted in poor performance of the existing firms in various industries, and impeded the introduction of new investment and technologies.

Such situation has also affected the sub-sectors studied in the second year, as described in the following.

2) Stuffed Toy Industry

There are relatively-large scale foreign affiliated firms, local medium-standing firms, small scale local firms, and micro scale subcontracting firms, in the stuffed toy sub-sector. The foreign affiliated firms and local medium-standing firms form the core of export sector, while the small scale local firms are still defective as exporting firms in view of their technological and management performance and exporting only in small scale. The existing stuffed toy manufacturers were established in recent years, mostly in and after 1989.

Philippine stuffed toy industry has no adequate local supply source of raw materials. Therefore, raw material supply ability was not regarded as an advantage of Philippine stuffed toy sub-sector; rather, the sub-sector was established taking advantage of the cheaper labor costs alone. However, the industry is hard to keep such advantage any more accordingly with increase in labor costs compared to that of the neighboring countries, and insufficient development of subcontracting system for the industry.

The domestic production of plush, which is the main raw materials for a stuffed toy industry, has just started recently, due to delay in modernization of textile industry in the country. The development of plush production, however, is still insufficient compared to that of neighboring countries, in that the diversification of product mixes of plush is still poor to meet the requirement of export oriented stuffed toy industry. The plastics processing industry has not been developed well also, due to insufficient domestic market for the industry caused by poor linkage among domestic industries. Therefore, supply of plastic parts is necessary to rely mostly on import. Such, structural deficit of raw material supply has reduced the cost competitiveness by making the industry rely more on expensive imported materials, and obstructed the establishment of domestic system of material supply, which is essential for upgrading the industry for medium and high-end markets.

Tardy development of small and medium businesses has prevented the stuffed toy industry from improving its efficiency. The export sector of the stuffed toy industry has increasingly refrained from engaging subcontractors and managed to include all the required manufacturing processes within their own factory. This is because of the poor performance of quality control and production management by the subcontractors. It has resulted in difficulty not only for the industry to absorb labor cost increase by subcontracting, but also to be flexible for change in volume of order booking.

3) Costume Jewelry Industry

The costume jewelry industry is mostly composed of small and medium scale exporting firms with micro scale manufacturing and subcontracting firms. Almost no large scale firm exists in the industry, because of the history that the industry has been established in the development process of Cebu locality. The materials used are limited to those which are available locally. The supply of metal parts and metal findings has relied on imported sources. Thus, since they have only an insufficient bases to promote tie-ups with advanced firms abroad or form linkages with these firms when then are established in the Philippines, it is essential for the industry as a whole to make effort to form such basis improving their technological, marketing and managerial performance.

4) Oleochemical Industry

The oleochemical industry consists mainly of foreign affiliated large scale firms, being different from the above two sub-sectors. One of two major local firms in the sub-sector was established based on the government's policy. Most part of market is dominated by world scale large firms, and emergence of local small and medium scale firms in the industry seems difficult. There were several firms which once entered into the industry, but most of them was forced to stop operation due to difficulty in marketing.

The supply of raw materials is dependent on the agricultural sector. However, due to failure of improving their production efficiency, the oleochemical sub-sector is faced with problems which are the matter of their existence bases; 1) unstable supply of raw materials, and 2) lack or price competitiveness of their raw materials.

In addition to the above, the industry is faced with difficulty in diversifying their product lines due to insufficient development of domestic chemical industry, which is to be the supply source of auxiliary materials. At the same time, since the size of domestic market is small, the industry has difficulty to develop it as a comprehensive industry, and remains solely as a supply base of basic oleochemicals to the industry abroad.

(2) Direction of Industrial Development Policy

1) Recommendation on Basic Strategy for Industrial Development

In the first year study report, the following recommendation was made on a development strategy for the Philippines on the perspectives common to the three sub-sectors comprised of this study.

1. 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. 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.

2. 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.

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

i) 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.

ii) 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.

iii) 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.

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:

i) 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.

ii) Implementation of the promotion measures of small and medium-scale business in strategic and preferential basis.

iii) Assigning a government agency responsible for sectoral approach.

iv) Using the vitality of industries and providing assistance for strengthening the organization of industry associations.

These recommendations are basically applicable also to the two sub-sectors comprised of this year's study except for oleochemical industry.

In the case of oleochemical industry, there is no dual structural characteristics, which is observed in other sub-sectors, and each firm has potentiality to perform business activities without any assistance from the government. Furthermore, these firms except for two of them, form a part of multinational firms or foreign invested firms. Therefore, operation of these firms are easily transferred to other countries of the more favorable business conditions in view of their strategy of international business operation.

Therefore, what is needed for the promotion of oleochemical industry in the Philippines include, 1) removal of impeding factors against their performing business activities, 2) improvement of supply condition of coconut oil by raising the productivity of coconut plantation and by rationalizing the coconut oil distributing so that coconut oil can cope with palm kernel oil, and 3) strengthening the R&D activities which is necessary especially in view of contribution to the Philippines economy, but difficult to attract the private sector's interest.

2) Progress in Indsutrial Development Policy

a) Industrial development policies

The basic direction of industrial development policy remains unchanged. The most notable progress in this field is the aggressive actions taken for improvement of investment environment, as typically seen in promulgation of Foreign Investments Act.

Another change during the period is formulation of a guideline, which is shown as Attachment A of IPP in 1991, to evaluate projects applied for IPP. This is the guideline to be used only for evaluation of applications under generic headings, and not used for the projects under the headings clearly stated.

However, it may be understood in a sense that this guideline clarifies the basis of formulation of IPP. The projects, which comply with this guideline, are regarded as the projects 1) eligible as competitive and strategic industry, and 2) economically desirable.

To qualify under the criteria for competitive and strategic industries, applications should comply with any of the following:

1. low Domestic Resource Cost (DRC) which indicates the international comparative advantage for producing the project's product
2. project which will produce goods that form part or are used in the production of other domestic products
3. project which will process the primary products of the agricultural productivity
4. project which will lay the ground work for industries that produce capital goods

As the guideline to test economic desirability of the projects, which pass the above criteria, followings are required.

1. project which have high EIRR (Economic Internal Rate of Return) and low FIRR (Financial Internal Rate of Return) (in other words, high economic effect, but not excessively profitable)
2. project which DRC is lower than the shadow exchange rate set by NEDA (in other words, high foreign exchange saving effect)

Thus, the strategic industries are required to have a potentiality to aim at a foreign exchange saving effect, an industrial linkage effect, and an effect to make full use of resources of primary industries. At the same time, it is also required to be a project which can be expected to have high economic effect, but not be excessively profitable.

b) Small and medium business development policies

In the area of small and medium business development policies, the RA No.6977, which is called the "Magna Carta for Small Enterprises" was approved by the President. Based on the act, a Small and Medium Enterprise Development Council (SMED Council) was created with members from DTI, DOLE, DENR, DOST, DAR, and DA. The RA No.6977 is to rationalize the small and medium business development policy through operation of the Council. The followings are the major rationalization thrust among others:

1. Rationalization of existing small and medium enterprise programs and agencies

2. Creation of Small Business Guarantee and Finance Corporation (SBGFC)

3. Mandatory allocation of 10% of total loan portfolio of all lending institutions to small enterprises

Of the above, the Central Bank has already indicated the guideline for the mandatory allocation of credit resources. The creation of SBGFC is under preparation stage, but rationalization of programs and agencies is still under study.

The following areas are assumed in the "Magna Carta" to receive the assistance for small and medium enterprises.

1. business and technical training
2. labor management
3. product/quality development and product diversification
4. the adoption of improved production techniques and commercialization of appropriate technologies
5. marketing and distribution, and the establishment of common service facilities
6. financing program
7. concessional interest rates
8. a mutual relief system
9. information dissemination and entrepreneurship education
10. tax credits and other tax and duty incentives
11. product experimentation and research and development
12. infrastructure facilities and public utilities improvement

c) Others

Other points to be paid attention regarding industrial development, are as follows:

1. Development of RIC (Regional Industrial Center): An effort to establish RIC including that of CALABARZON, and preparatory work for development of off-site infrastructure of RIC is in progress.

2. Development of Industry Rationalization Program: the rationalization program is being developed in cement industry, electronics industry and automobile industry.

3. Formulation of Local Government Code: The code is to transfer a part of authority of the central government to regions, and develop a regional government system. It is expected for the regional governments to play an important role in industrialization promotion in their regions, though the authorization transferred to the regional governments, for the time being, is limited to those related to 1) public works, 2) health, 3) agriculture, 4) social welfare, 5) a part of tourism, and 6) school construction.

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

1) Introduction

In the first year study report, the following was recommended with regard to development of industrial associations, expecting the leadership of industry associations in promoting and organizing the sub-sector promotion and development program:

The most important thing for the Philippines to do in relation to its industrial development is to assist the industry, with utilizing the vitality of the private sector, to enable the industry to develop themselves in response to such international movement as transfer of production bases abroad and development of parts/materials complementary schemes among these bases abroad. 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) defining of qualification of adequate industry 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.

2) Present Conditions of Industry Associations in the Sub-Sectors Studied in the Second Year

As discussed in the first year study report, 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.

PHILTOY, which covers toy manufacturers mainly of dolls, plastic toys, and games, etc., is the sole industry association for the stuffed toy manufacturers. Membership coverage of PHILTOY is still low not only among the medium standing firms including that of foreign affiliated ones, but also among the local micro and small scale firms. Some of the toy manufacturers produce handicrafts in parallel with toys, and some of them join PCHI (Philippine Chamber of Handicraft Industries).

There are two industry associations in the costume jewelry industry; one is CEBU-FAME which organizes the manufacturers and exporters in Cebu, while other is FAMA-PHIL which covers the firms in Metro Manila. CEBU-FAME is regarded as an industry association covering a specific region, whereas FAMA-PHIL concentrates their membership to the advanced firms in the industry putting qualification requirements to their members. FAMA-PHIL's intention is to improve their technological and management performance through mutual efforts among the advanced firms, instead of extending their membership coverage to the whole industry.

In the case of oleochemical industry, POMA organizes major firms in the industry as one of membership organization of AOMG, which represents the industry organizations in ASEAN region. The members of the POMA are the world known firms, different from those in other two sub-sectors, main members of which are small and medium scale enterprises.

(Detail of organizations and activities, etc. of industry associations are included in the parts of respective sub-sectors.)

The chief activities of industry 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 the case of the Philippines, there is a need for further study on the possibility of industry associations providing additional functions and carrying out other activities including:

1. In view of the inadequacy of the present financing system for small and medium businesses, to provide a base for financial guarantees loans or a mutual aid system to help with the development of the financing system.

2. Complementing the government activities, to provide member firms with information and application assistance in relation to the various encouragement and preferential treatment programs with objective of improving management within the industry.

3. To provide an integrated representation function of the industry and coordination function among the industry and the various government agencies as the pipeline between the industry and the government, when there are various government agencies related to this industry and they implement their policy measures individually.

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.).

2. Investment Promotion Policy

2-1 Overview

The Foreign Investment Act was enacted in July 1991 as part of a series of institutional reforms referred to in the first year study report. There are indications that consideration of institutional measures for the improvement of the investment climate supporting the act will get under way around the beginning of 1992.

This indicates that the revision of investment policy has been recognized as the most urgent issue among the various measures to support industrialization.

A Joint Congressional Review and Inquiry Committee session held in May 1991 during deliberations on the Foreign Investment Act concluded that Filipino capital alone cannot supply the full amount of investment required in the 1990s and that the attraction of foreign direct investment is crucial.

This conclusion reconfirmed the role which foreign direct investment is expected to play in the revival and growth of the economy under the Medium-term Philippine Development Plan 1987-92. The plan emphasizes the importance of the central role which foreign direct investment could play in the generation of employment opportunities and the development of export-oriented business.

The factors behind the urgent need for the improvement of investment policy may be summed up as follows:

The following can be pointed out as domestic factors.

1. Total capital formation in the country remains at a low level of about 15 percent of GNP.

2. The size of the population entering the labor market each year has grown from 600,000 in the early 1980s to more than 800,000 at the beginning of the 1990s.

3. Exports are stagnant and the economy is growing at a slower pace. The real growth rate for 1990 was 3.1 percent and that for 1991 minus 0.05 percent. Year-on-year growth in exports, which stood at 10.5 percent in 1989, slowed to 4.7 percent in 1990, and to 8.0 percent in 1991.

4. Taking the length of time required for Congressional deliberations on policy decisions and the transitory period following any change in administration into account, it is desirable that the basic framework of the main revisions under consideration be established before the presidential election scheduled for May 1992.

The following may be cited as external factors.

1. Economic management remains restricted by the sizable cumulative external debt. Some of the indicative targets which were fixed as prerequisites for obtaining new money under international financial cooperation schemes, including reductions in the fiscal deficit, have become increasingly harder to achieve.

2. The relatively more successful economic performance of the surrounding ASEAN countries is receiving wider recognition. In comparison with these countries, the Philippines is lagging behind and there is room for improvement in the introduction of foreign direct investment and export-led economic growth.

3. New "players" who are actively seeking to attract foreign direct investment have entered the scene in Asia.

The funds supporting total capital formation comprise the following elements:

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

For the Philippines, there are limits on the expansion of (A), (C) and (D) due to debt management and repayment requirements. Regarding (A), the fiscal deficit in 1990 stood at 3.6 percent of GNP with few significant progress made toward improvement. Regarding (C) and (D), a framework outlining the size of the fund inflow for the period 1989-92 has been fixed under international financial cooperation centering on the IMF.

The decisive factors in domestic capital formation will be domestic private capital (B) and foreign direct investment (E). In particular, (E) means an inflow of foreign capital which is not accompanied by an increase in debt.

The domestic investment rate of 15 percent as of 1990 is lower than the rate actually realized in the second half of the 1970s, when stable medium-term growth was achieved. It is also lower than the rate required to meet the need to create domestic employment opportunities. A Letter of Intent sent to the IMF in March 1989 set the desirable annual average rate of growth for 1989-92 at 6.5 percent and targeted the corresponding investment rate at 23 percent.

In general, an increase in the investment rate requires a higher domestic saving rate, an increase in inflow of foreign investment, or a combination of both. In reality, however, there is strong evidence that domestic saving rates rise only as a result of sustained economic growth. No major change in the saving rate can be hoped for now that economic activity has stagnated once again in 1990-91, partly due to natural calamities.

In order to recover economic buoyancy, the cycle of low growth to low saving rate to low total capital formation to a standstill in development must be halted. It is hoped that by actively addressing the attraction of foreign investment, the vicious cycle can be stopped and that a favorable cycle will take its place.

The following measures, which are closely related to DTI/BOI, indicate some of the new directions which are being taken.

First, under the policy of deregulation, BOI's role and functions are changing from those of a regulatory agency to those of a policy formation unit.

Second, it has become important that industries targeted for investment be organized under a negative list or a positive list (reorganization of the IPP list or the focused IPP).

Third, non-fiscal measures for investment promotion have become more important due to the budgetary constraints mentioned earlier. Measures that do not depend on preferential fiscal treatment should be considered in concrete terms. A tendency to gradually reduce BOI's regulatory role in the authorization of incentives for investment promotion has emerged and thus it has become increasingly necessary to strengthen BOI's function as a body to develop strategies for the promotion of foreign investment. .

2-2 Effectuation of 1991 Foreign Investment Act

The 1991 Foreign Investment Act was finally signed into law by the President on June 13, 1991, and it became effective as Republic Act No. 7042 on July 1. This policy decision came after 18 months of joint Congressional coordination.

As mentioned in the first year study report, the Paterno bill and the Teves bill were laid before the Senate and the House of Representatives respectively. Although both were intended to effect a drastic improvement of the investment climate, there were deliberations on whether the transitory period should be three years or five and whether or not a negative list should be adopted. Coordination between the two Houses was undertaken after a series of public hearings to which major private enterprises and industry organizations were invited.

The main contents of the Act may be summarized as follows:

1. The transitory period has been defined as a period of three years after the effectuation of the Act.

2. There are now two paths for registration of foreign investment: one is BOI (foreign investment with incentives based on the Omnibus Investment Code) and the other SEC (foreign investment without incentives).

3. In principle, there are no restrictions on equity participation in export enterprises by foreign nationals.

4. Foreign nationals may participate up to 100 percent in the equity of domestic market enterprises if the enterprises are outside the fields on the Negative List.

5. Foreign Investment Negative Lists A, B and C are adopted.

6. The minimum standard size of foreign investment is fixed at US$500,000 in terms of paid-in capital (Negative List B).

7. Presentation of conception of "strategic industries": NEDA shall publish a list of industries strategic to the development of the economy within 18 months after the effectuation of the Act.

The 1991 Foreign Investment Act is regarded as an indication of a move toward deregulation. The traditional majority principle of 60 :40 (domestic capital should, in principle, hold no less than 60 percent of equity) in favor of the Philippine side is relaxed to allow for more positive attraction of foreign investment.

In the process from the effectuation to implementation of the Act, several characteristics can be pointed out as follows:

First, the Act is in force rather progressively with a limited period. Second, a timetable of stages for the implementation is prepared. Third, scrupulous care is taken to integrate policies of relevant government agencies centering on the National Economic and Development Authority (NEDA). And fourth, methods are adopted to grasp reactions from the industrial community on the effects of deregulation during the transitory period.

Mapping out of the Negative List has been assigned to NEDA.

The mass media, retail trade, regional banks, etc., are reserved for Filipino activities by the Constitution and nationalization laws. They are classified under List A.

List B covers defense-related activities, enterprises having implications on public health and morals and participation in small and medium-sized domestic market enterprises with paid-in capital of less than the peso equivalent of US$500,000 unless they involve advanced technology as certified by the Department of Science and Technology (DOST).

List C (enterprises open only to Philippine nationals in the transitory period) includes import and wholesale activities not integrated with production or manufacture of goods. NEDA will make a final decision on the matter after public hearings.

These are called the "Transitory Foreign Investment Negative Lists" because they are valid only for three years. The Regular Negative List will be published 60 days before the end of the transitory period. Implementing rules and regulations were published October as scheduled together with the Transitory Negative Lists within 120 days after the effectuation, upon consultation with the Board of Investments (BOI) and the Securities and Exchange Commission (SEC).

Moreover, a list of strategic industries will be formulated and published by NEDA within 18 months after the effectuation of the Act. The list shall specify the desired equity participation by Government and/or private Filipino investors in each strategic industry.

The institutional improvement of the investment climate as represented by the 1991 Foreign Investment Act is expected to continue during the period, prior to the presidential election scheduled for May 1992, fixed as the target. BOI's annual report published in the middle of 1991 cites the following as major institutional reforms already under consideration:

1. Application of Condominium Law to industrial estates

Aiming to ease the laws on land ownership, the measure seeks the horizontal application of the existing Condominium Law to industrial sites or estates, where foreign firms locate their factories, and the guarantee to foreign firms of the right of land occupation throughout the period in which they operate their factories. (House Bill 30884)

Also being considered is a supporting bill under which foreign companies could obtain a straight 50-year lease without the need for renewal. This would replace the current framework (basically 25 years with possible extension for an additional 25 years) for the leasing period of industrial estates.

2. Expansion of corporate status on equity investment

This measure would have equity investments by regional ASEAN or multinational financial institutions, including their subsidiaries, considered as investments by Philippine nationals. (House Bill 30521)

3. Accelerated depreciation and net operating loss carry-over

With a view to promoting new investments, the measure would provide newly-founded firms with these incentives at the initial start-up stage. The bill contains amendments to the Internal Revenue Code. (House Bill 30522)

Under consideration in connection with this bill are the extension of incentives involving taxes and duty-free import of capital equipment, spare parts and supplies provided under the Omnibus Investment Code. However in the long term the effects of these incentives on investors are expected to lessen by stages through the promotion of a series of across-the-board import duty reductions on capital goods and parts announced by E. O. 470 in July 1991.

2-3 Investment Activity in Asia and the Philippines

It is now widely recognized that the inflow of direct investment of foreign private capital into the Asian region which began to grow in the latter half of the 1980s should be led to the Philippines as well. The foreign direct investment boom, which was touched off directly by the Plaza Agreement in September 1985, was first observed in R. Korea, Taiwan, Hong Kong and other NIEs and then spread to Thailand, Malaysia and Indonesia. (Table II-2-1)

The main recipient countries and territories of this foreign investment developed positive measures to attract foreign investment in and after 1986. The measures involved mostly the relaxation of controls and included the introduction of new preferential treatment measures and the opening of sensitive sectors. Taiwan and R. Korea led the way, followed by Thailand, Malaysia and Indonesia. A favorable cycle of foreign investment and export industrialization spread from the Asian NIEs to ASEAN, providing the engine for economic growth.

The Philippines instituted the new Omnibus Investment Code in 1987 and this led to a remarkable increase in the inflow of foreign investment in 1988. But it has become increasingly clear that the Philippines has relatively more room for improvement in the size, growth rate and maintenance of the momentum of growth in annual foreign investment introduction in comparison with the surrounding nations.

During the process of deliberations on the Foreign Investment Act, it was often pointed out that new recipient countries (Vietnam, etc.), which are eagerly looking forward to foreign investment, would catch up if the Philippines remained idle.

A policy decision placing emphasis on a timetable and a transitory period, as witnessed in the Foreign Investment Act of 1991, may be said to show efforts to cope with the international environment within the present regime's remaining time in office. In this sense, the three-year transitory period is in effect a period for encouraging foreign investment.

Foreign investment introduction in the Philippines obviously bottomed out in 1986 and it has subsequently tended to increase. Table II-2-2 shows the trend in investment based on the BOI approved statistics.

Between 1989 and 1991, it was feared that foreign investment might decrease because of a series of natural calamities including drought, an earthquake in northern Luzon, a typhoon in the Visaya region and a volcanic eruption. Nevertheless the growth in foreign investment beginning in 1987 continued up until the first half of 1991, indicating a strong desire on the part of foreign investors to invest in the Philippines.

Total investment of domestic and foreign capital in terms of project costs amounted to 83.5 billion pesos in 1991. This fell below the 85 billion peso investment target set for 1991. (The government began fixing targets since 1988). The ratio of domestic to foreign capital in 1991 was 51 to 49.

Approvals for foreign investment alone amounted to 23.3 billion pesos (in terms of paid-up capital) in 1990, or an increase of 34 percent over a year earlier. In 1991 investent fell 7.7 percent to 21.5 billion pesos. The surge in investment in 1989 and 1990 was due to a radical increase in investment by neighboring Asian countries and territories. Japan was the largest investor over these two years, followed by Taiwan and Hong Kong occupying 2nd and 3rd places respectively and each maintaining high levels of investment. In 1991 the U.K. was the largest investor in the philippines by virtue of the fact that it received approval for a large-scale petroleum investment project. Investment from Taiwan and Hong Kong slowed in that year.

The fields of investment are becoming increasingly diversified. In the manufacturing field, major targets of investment are electronics, apparel, metal processing, automotive parts (transmissions and engines) and chemicals. The development of industrial estates, which was incorporated into the Investment Priorities Plan (IPP) in 1989, also contributed to the growth, with six firms registering at BOI by the end of 1990. Examples of those taking advantage of the new investment opportunities include communication services and power generator installation projects. Investment in the tourism sector including hotel construction also has become active.

Noticeable trends in recent years are the increase in the number of capital-intensive projects and the dispersion of factories to the provinces which are beginning to be reflected in the BOI statistics. The size per unit of invested capital in terms of project costs indicates these trends (Table II-2-2). Incorporation into IPP of the opening of industrial estates and the communication services, power and other energy-related sector projects stated earlier are also responsible.

The dispersion of factories to the provinces is supported by a regional dispersal plan adopted in 1987 to promote location of factories in areas other than the National Capital Region (NCR).

According to BOI approval statistics, firms that located their factories in the NCR in 1990 accounted for 24 percent of the total. Regions III and IV are the main factory locations outside the NCR, accounting for 45 percent of all projects.

Notable in connection with this trend is the progress for receiving new investment by way officially supported plans to improve the infrastructure in Region IV which comprises the Cavite, Laguna, Batangas, Rizal and Quezon provinces. The Calabarzon plan is under way in the region as one of the five special development projects adopted under the Philippine Assistance Program (PAP) or the Multilateral Assistance Initiative (MAI). Similar to this survey, the master plan for the Calabarzon plan is being mapped out as a JICA study. Industrial estate projects by the private sector are also active in the region and thus there is reason to expect the early materialization of many related investment venturers.

Table II-2-1: Foreign Investment in Asia

	1987 Value	1987 Growth over previous year (%)	1988 Value	1988 Growth over previous year (%)	1989 Value	1989 Growth over previous year (%)	1990 Value	1990 Growth over previous year (%)
R.Korea (million $)	1,060.2	199.7	1,282.7	21.0	1,090.3	-15.0	802.5	-29.4
Taiwan (million $)	1,418.8	84.2	1,182.5	-12.7	2,418.3	104.5	2,301.8	-4.8
Singapore (million S$)	1,448.0	21.7	1,657.8	14.5	1,625.4	-1.2	2,217.5	36.4
Malaysia (million ringitts)	750	43.0	2,010.5	168.1	3,401.2	83.1	6,227.9	69.2
Thailand (million bahts)	50,138	359.6	158,066	215.3	205,495	30.1	361,470	75.9
Philippines (million pesos)	3,427	114.1	9,523	177.9	17,481	83.6	23,369	31.2
Indonesia (million $)	1,484	79.7	4,408	197.0	4,718	7.0	8,751	85.5
China (million $)	3,708.8	30.9	5,297.1	42.8	5,599.8	5.7	6,596.1	17.8

Source: Compiled from foreign investment statistics

Table II-2-2: BOI Approved Foreign Investment

	1986	1987	1988	1989	1990	1991
Number of project (Number)	501	1,432	1,337	2,504	3,082	2,124
Project cost (billion pesos)	3.18	9.84	30.97	70.78	108.43	83.51
Annual target (billion pesos)	-	-	(20.00)	(60.00)	(80.00)	(85.00)
Cost/project (million pesos)	6.4	6.9	23.2	28.2	35.2	39.3
Direct job creation (thousand persons)	26.2	82.1	127.9	184.4	125.1	75.5
Approved investment (equity base in billion of pesos)	3.146	8.359	16.944	39.684	48.032	43.697
Filipino	1.553	4.932	7.421	22.203	24.663	22.185
Foreign	1.594	3.427	9.523	17.481	23.369	21.512

Source: BOI

Table II-2-3: Foreign Investment in the Philippines

(equity base in milllion pesos)

	1983	1984	1985	1986	1987	1988	1989	1990	1991
Japan	56	568	485	454	591	2,015	3,428	7,437	5,778
U.S.	2,029	1,709	1,087	458	740	3,229	2,852	1,446	2,394
Taiwan	5	13	13	7	186	2,317	3,232	3,419	330
Hong Kong	48	168	63	149	570	566	2,886	5,064	228
China*	18	43	112	38	169	557	740	441	564
U.K.	60	34	355	135	210	485	308	477	7,826
Other	762	1,366	335	353	961	814	4,035	5,086	4,392
Foreign capital total	2,978	3,901	2,450	1,594	3,427	9,983	17,481	23,370	21,512
Filipino capital total	2,239	2,214	2,251	1,553	4,932	7,421	22,203	24,663	22,185

*: Resident Chinese in the Phlippines
Source: Compiled from BOI statistics

2-4 Japanese Firms' Interest in Investment in the Philippines

According to Ministry of Finance statistics, Japanese firms' direct investment in the Philippines began to increase both in number and value in 1988 and the upward trend continued in the following three years. In fiscal 1990, Japanese investment grew in value, although it declined in number.

Compared with investment in the other ASEAN nations, however, the statistics show that investment in the Philippines remains at a relatively lower level in the number of cases annually and in value (Table II-2-4).

The tendency is particularly noticeable in the annual growth rate since 1986. Growth in investment in the Philippines was relatively lower than the continued high rate of growth in investment in Thailand and Indonesia until around 1990. The trend may be regarded as similar to the positioning of the Philippines observed from host country side statistics in Asia stated earlier.

As shown in the introduction, a questionnaire survey is being conducted among Japanese firms in the toys and costume jewelry industries. As of September, 40 toys and 50 costume jewelry companies had replied.

A primary objective of the survey was to find out what kind of information the Japanese firms would like to receive with relation to the future direction of BOI's function mentioned earlier when they consider expanding business with the Philippines.

Table II-2-5 shows replies from the toys and costume jewelry firms.

1. At the time of the survey, both toys and costume jewelry firms were more interested in closer cooperation through processing on assignment. In both sub-sectors, there are cases where business expansion is being considered or where firms are ready to begin considering expansion.

2. The most important information concerning investment in the Philippines is the situation of raw material supply. This is common in both the toys and costume jewelry industries.

3. The basic political and economic situation is regarded as equally important (particularly by toys firms).

4. Costume jewelry firms strongly interested in imports or processing on assignment are concerned about in receiving information on local enterprises or export systems.

5. Interest in production costs is strong in both sub-sectors.

In their replies, the Japanese firms cite problems of insufficient quality control, unstable delivery and unsatisfactory response to demands for small-lot and short-cycle production.

In the comments written on the surveys, the labor force is commonly seen as a favorable factor. On the negative side, however, it appears that many have the image of an unstable political situation. The respondents hold the view that the insufficiency or total lack of exchanges on the personal or industry organization level hinders business expansion. They say few approach has been made by the industry.

Considering the situation outlined above, it may be said that there is wide room for improvement in the industry's access to Japanese firms.

It is desirable that activities such as investment seminars, distribution of guidebooks on investment and dispatch of investment promotion missions be expanded on the initiative of the Philippine side. It would be effective to hold series of seminars based on themes such as cost factors, export systems or information related to the situation of individual industries. For example, it is desirable that information be provided or seminars held solely regarding industrial estates and cost factors.

Philippine investment seminars have already been held in Tokyo or provincial cities in Japan by BOI, through the cooperation of the ASEAN Centre, the Shoko Chukin Bank and private banks (concluding business agreement with BOI of the Philippines in 1989), and in cooperation with JETRO. Seminars held in Tokyo in March and September 1991 drew more than 300 and 400 participants respectively, exceeding original expectations. This indicates the potentially strong interest in investment on the side of Japanese firms.

In the future, it is desirable that the investment promotion activities aim at building the image of the Philippines as a whole.

Table II-2-4: Japan's Investment in the Philippines and other ASEAN Countries

Upper line Number of cases
(Lower) Value in US$ million

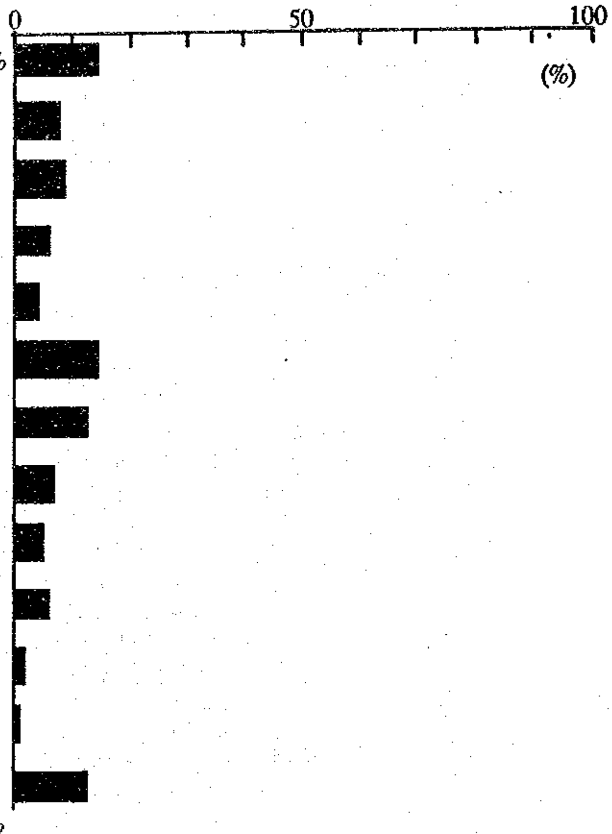
	Philippines	Thailand	Malaysia	Indonesia	Singapore	World Total
'80	36 (78)	58 (33)	132 (140)	96 (529)	132 (140)	2,442 (4,693)
'81	28 (72)	52 (36)	164 (266)	88 (2,434)	164 (266)	2,563 (8,932)
'82	19 (34)	66 (94)	154 (180)	84 (410)	154 (180)	2,549 (7,703)
'83	20 (65)	73 (72)	184 (322)	89 (374)	184 (322)	2,754 (8,145)
'84	12 (46)	76 (119)	108 (225)	82 (374)	108 (225)	2,499 (10,155)
'85	9 (61)	51 (48)	110 (339)	62 (408)	110 (339)	2,613 (12,217)
'86	9 (21)	58 (124)	85 (302)	46 (250)	85 (302)	3,196 (22,320)
'87	18 (72)	192 (250)	64 (163)	67 (545)	182 (494)	4,584 (33,364)
'88	54 (134)	382 (859)	108 (387)	84 (586)	197 (747)	6,076 (47,022)
'89	87 (202)	403 (1,276)	159 (673)	140 (631)	181 (1,902)	6,589 (67,540)
'90	58 (258)	377 (1,154)	169 (725)	155 (1,105)	139 (840)	5,863 (56,911)
* Total	850 (1,580)	2,465 (4,422)	1,509 (3,232)	1,873 (11,540)	2,559 (6,555)	63,236 (310,808)

(N.B.) Aggregate as of end of March 1951 - 1991. Fiscal 1990 covers April 1990 - March 1991.
Source: Monthly Data of Financial Statistics;Ministry of Finance

Table II-2-5: Japanese Firms' Interest in Investment and Business with the Philippines

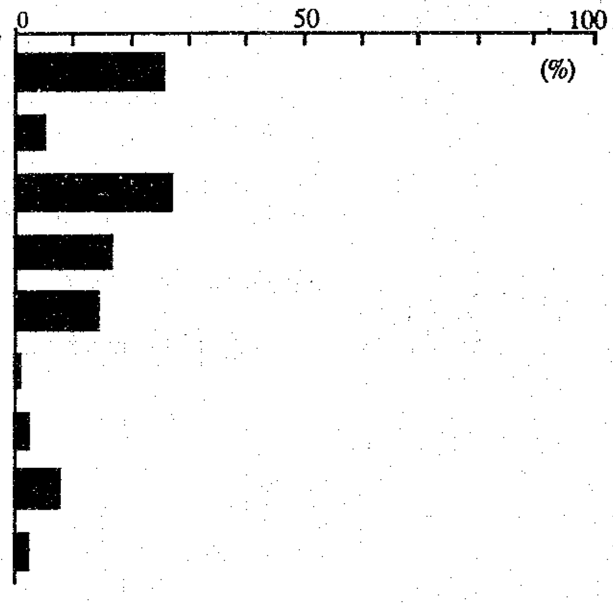
<Toys> Information Japanese firms want to obtain when they invest in the Philippines

1. General situation of politics, economy and society	17 (14.3) %
2. Measures for favorable treatment of investment	9 (7.6)
3. Investment climate regarding export processing zones	10 (8.4)
4. Restrictions on foreign capital	7 (5.9)
5. Infrastructure preparation	5 (4.2)
6. Purchases of raw materials and resources	17 (14.3)
7. Wages	15 (12.6)
8. Working conditions	8 (6.7)
9. Labor laws and regulations	6 (5.0)
10. Moves of local firms and foreign enterprises and information on both	7 (5.9)
11. Living environment	2 (1.7)
12. Others •On investment: Safety, quality and time of delivery	1 (0.8)
No replies	15 (12.6)
	119 (100.0) %



<Costume jewelry> Information in which Japanese firms are interested when they import from (or process products on assignment in) the Philippines

	%
1. Situation of raw material supply	20 (25.0)
2. Wages	4 (5.0)
3. Production costs	21 (26.2)
4. Information on local firms	13 (16.2)
5. Situation of export environment preparation	11 (13.8)
6. Measures for favorable treatment of investment	1 (1.3)
7. Investment climate regarding export processing zones	2 (2.5)
8. General situation of politics and economy	6 (7.5)
9. Others	2 (2.5)
	80 (100.0)%



2-5 Recommendations on Investment Promotion Policy

Expansion of investment, including foreign investment, is a central issue for the revival of the Philippine economy.

Results of investment so far indicate that the country has lagged behind neighboring nations in terms of the comparative value or growth rate. Moreover, competition to attract foreign investment in Asia is becoming increasingly fierce. In order to reverse this trend, the vicious cycle of low growth to low saving rate to stagnant gross capital formation will have to be broken by actively dealing with the attraction of foreign investment. It is essential that successful examples of investment be monitored, that the external image of the country be improved and that a more favorable cycle be achieved.

It is hoped that DTI/BOI will see the active interest that foreign investors are showing in Asia and the Philippines in the early 1990s as a good opportunity for the Philippines. In order to gain more than merely expressions of interest from investors, continuing with the policy of easing regulations is expected. Overseas investors are concerned about the direction of foreign investment policy to be shaped after the election scheduled for 1992. The implementation of changes to the foreign investment policy is believed to offer a good chance to improve the Philippines' credibility in the eyes of foreign investors.

The Foreign Investment Act as mentioned above creates a transitory period and is regarded as legislation which actively encouraging foreign investment. It would be desirable for a stragegy of actively attracting foreign investment giving regard to the following points to be adopted in the process of the progressive implementing schedule.

1. In line with the scheduled steps for the implementation of the Foreign Investment Act of 1991, it is desirable that important policy decisions be announced collectively in a package which clarifies their targets and interrelations to the outside world, particularly towards the investors interested in this matter.

2. It is also expected that those important decisions made alongside the implementation of the scheduled steps consistent.

3. A strategy for the improvement of the country's image should be promoted. When the above-mentioned policy decisions are announced, efforts should be concentrated on the improvement of the image of the Philippines as a country ready and able to receive foreign investment.

4. The following are important in the establishement of the above-mentioned legal environment planned for the future.

The first is in regard to the Condominium Act. Many firms conduct their investment activities on the basis of long term strategies and thus show great interest in leasing terms and the securement in advance of land necesssary for future facilities expansion. The petition seeking the ammendment of the law jointly submitted at the end of 1990 by Foreign Chambers of Commerce and Industry in Manila mentioned in the first year study report also emphasized this point.

Secondly it is important that the tax exemptions for the import of capital goods and parts be extended. It is believed that the above incentives will lose their significance following the series of tariff reductions on a number of capital goods and parts planned in E.O. 470. However, it is important to observe the effects of these reductions in the interim time. The extension of these incentives which expire in 1992 will be viewed by foreign investors as the adherence to consistent policy.

The third point regards accelerated depreciation and net operating loss carry over. Such measures strengthen incentives for new investment. However, BOI has said that it plans to study the possibilty of reducing some of the incentives already existing under the Omnibus Investment Act of 1987 when these measures once have been implemented.

How to reconcile the opposing directions of expansion and reduction of incentives is an important issue. It is expected that adequate consideration be given to the development of export industries in the policy formulation process. In order to lead industrial choices in a desirable direction, rather than reducing incentives across the board, revisions should be made on a more selective basis. Moreover, when such decisions are made these should be comprehensively clarified and announced in the form of a policy package.

Comprehensive policy formulation for the taxation laws relating to accelerated depreciation and net operating loss carry-over, and the above mentioned tax exemptions for imports of capital goods and parts are required. Many foreign investors hold both expectations and concerns regarding this.

The same can be said of the conclusion of Regular Negative List to be published after the elapse of the transitory period. It is expected that consideration be given to these factors and that clear announcement to foreign investors be made.

BOI functions as an intermediary for investment administration and investment promotion activities. When it was established in 1968 it was placed under the direct control of the Office of the President. However in 1987 it was made part of the Industry and Investment Group, a DTI body (Administrative Code 1987).

Under the Code, the Board's main role was made the formulation and implementation of short, medium and long term industrial plans as well as the promotion of invesments in the Philippines in accordance with national policies and priorities. Its role is also stated to include registering, monitoring and granting of investment incentives to individual enterprises and the formulation of policies and guidelines aimed at creating an environment conducive to the promotion of investments.

BOI is divided into three main components: 1) the Support Service Group, 2) the Industry Group A, and 3) the Industry Group B. (Fig. II-2-2)

The Support Service Group runs the Investment One Stop Action Center which was established to facilitate investors in various field from giving approvals for investments to procedures for the establishment of companies and import tariff exemptions The procedures have been simplified and the time needed to process applications for foreign investment reduced to between 2 and 3 weeks from the date of application.

The two other groups serve different industries and each comes under the general supervision of the Executive Director. Even within DTI/BOI the groups have the important role of following the situation of Philippine industries. In October, 1987 DTI/BOI oversaw a study to achieve outlooks till the year 2000 of 52 sub-sectors (a Ten Year Program). The Groups compiled results for a survey of about 27 sub-sectors. The sectoral approach is becoming established as an important method and efforts are being made to begin joint monitoring of the industries between governemnt and the public sector.

In order to widen the scope of its operation, it is strengthening its ties with foreign countries and aims to establish regional extension offices in accordance with the policy of decentralizing industry dispersal policy. Regarding the former, in 1990 nine overseas missions were dispatched and 27 were received. Since October 1989 Japanese advisors have been sent by JICA to give advice on investment policy.

The establishment of BOI regional extension offices has been progressing since 1988. As of 1991 offices in Cebu, Davao, Cagayan de Oro, Legaspi, and Iloilo had been established. The offices provide services for investors.

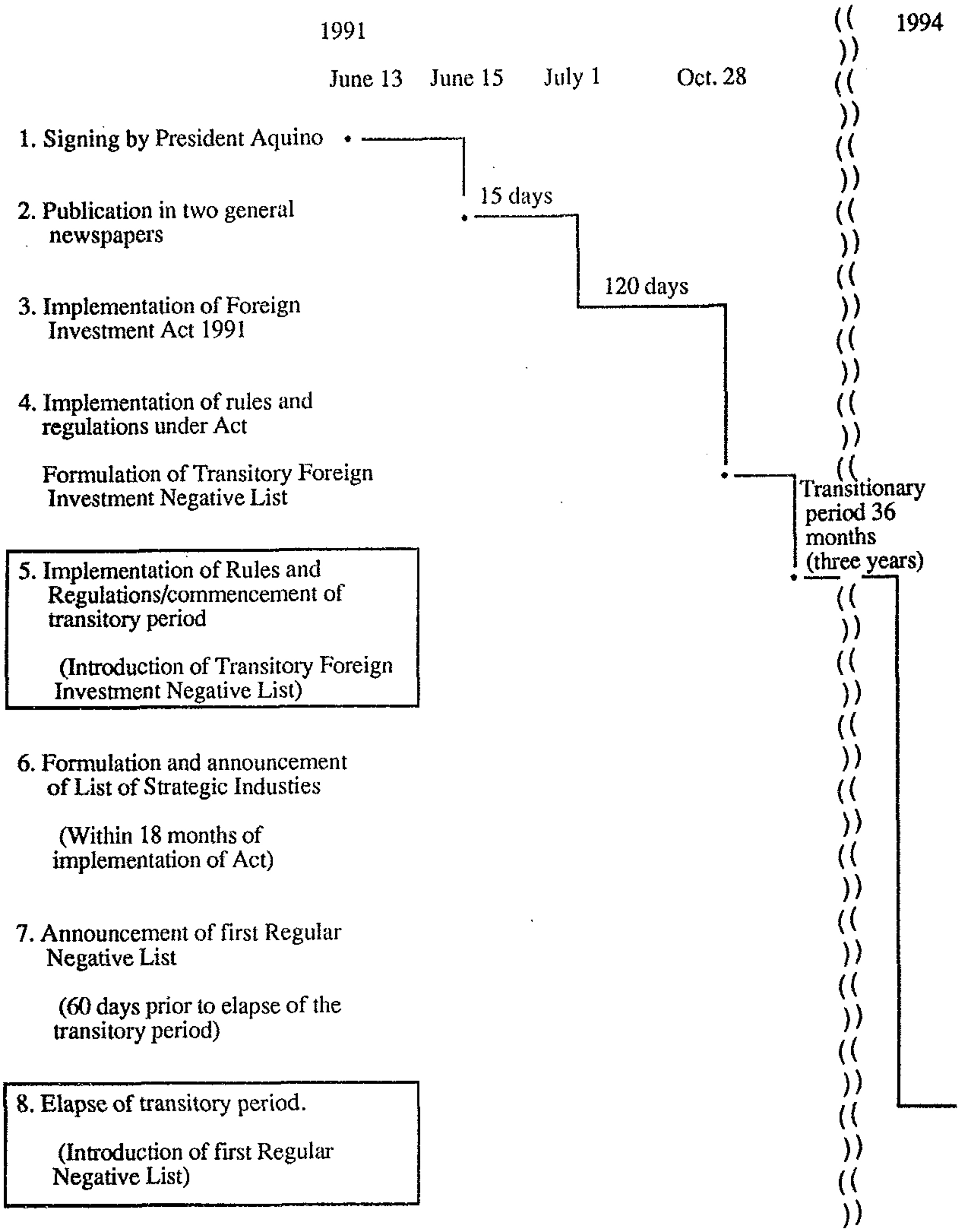
In 1991 there were 417 positions in BOI but only 344 employees. Its budget was reduced from 69.1 million pesos in 1990 to 50.14 million pesos in 1991 and there has arisen a need to review and reorganize the board's activities.

For these reasons the most important issues for BOI at this stage are the the reorganization of its activities in accordance with the development of policy. Two points regarding the direction of its structure and functions can be summarized as follows.

1. Shift of BOI functions: Among the current BOI functions, activities of a strong regulatory nature, such as authorization or provision of incentives, is being reduced by stages with the progress of deregulation. It is desirable that the emphasis of BOI function be shifted to mapping out industry nurturing policies, monitoring the processes to the realization of investment and positive investment promotion activities.

2. Enhancement of information services before and after approval: First, complete arrangements should be made to allow DTI/BOI to conduct surveys concerning the specific sub-sector on their own. Second, the processes of implementing the promotion measures should be monitored. Third, investment processes from approval to implementation should be monitored. Successful examples of investment thus observed are expected to offer the key to further attraction of additional projects.

Fig. II-2-1 Schedule for Implementaiton of 1991 Foreign Investment Act



3. Trade Policy

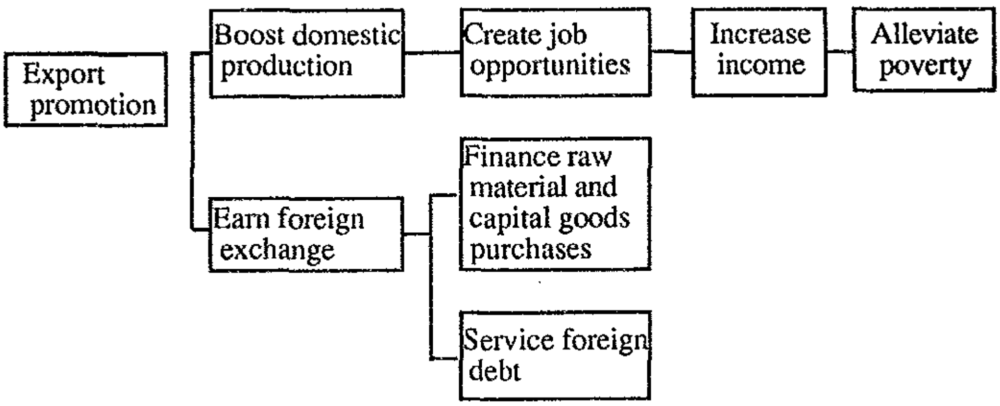
3-1 Basic Policy for Trade Promotion

Storm and flood damage and earthquakes combined with the Gulf War and higher crude oil prices to deliver a severe blow to the Philippine economy, which recorded double-digit inflation and experienced a severe slump in economic activities in 1990.

Signs of a recovery finally began to appear in the first quarter of 1991, and growth in the 3% range was forecast. Then came the eruption of Mt. Pinatubo and another serious blow to the economy. In 1991 real GNP shrank 0.05%, the first negative growth rate recorded since 1985.

The government authorities have been working desperately in relieving damage and rebuilding the economy. They are moving ahead with restraints on interest rate increases, which are hindering economic development, the cultivation of industrial competitiveness, gradual liberalization of imports and the improvement of infrastructure, all of this to create a system in which commercial activities are liberalized and the principle of market competition works.

The government position is that trade is one of the keys to economic growth, and great efforts are being made to promote exports as a means of eliminating poverty, repaying cumulative external debts, creating jobs and improving income standards.



3-2 Promotion and Modification of Trade Policy

The trade policy of the Department of Trade and Industry (DTI) is based on a vision ("Development and Industrialization: Our Vision") announced in October 1989. New export policies laid out in 1991 are summarized below.

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 bring together relevant proposals, and the Export Development Bill was submitted to the Congress in November 1990. In the first half of 1991, deliberations and public hearings were held on the bill in the House of Representatives, and some changes were made. At the end of November, 1991 the revised bill had been jointly submitted under the names of the chairmen for Committee on Economic Affairs and Trade & Industry in the House of Representatives, but the bill still remains under consideration.

The main points of the revised bill include the establishment of an Export Development Council, streamlining of government export promotion policies and functions, promotion of mutual ties between private exporters, and the provision of export incentives to export corporations.

The deliberating council is chaired by the President and is comprised of eight representatives from government and six from the private sector. It convenes once each quarter.

As a supreme body, the council has the right to propose and adopt export promotion plans, and it establishes policies and regulations concerning export planning and provides assistance to export corporations. Incentives are also provided to registered export corporations and trade industry associations.

BETP supervises the council secretariat and is responsible for authorizing exporter associations and coordinating and managing incentive programs.

The main incentives provided to registered export corporations and non-profit, non-stock exporter associations are listed below.

1. Exemption of import duties on raw materials, semi-finished goods, machinery and components

2. Priority allocation of foreign exchange by the Central Bank

3. Exemption from the overseas travel tax

4. Exemption from the requirement to pay import duties in advance when opening a letter of credit

5. Authorization to retain 25% of foreign exchange earnings

6. Loans using overseas loans by the government as a source of revenue are available, and the interest rate is limited to the original rate plus a margin of 5%.

7. Tax deductions for expenses incurred in export promotion activities (equivalent to 150% of all expenses incurred abroad).

Notes:

(1) Here, the term *exporters* refers to 1) those firms engaged in production/processing and commerce and for whom foreign exchange accounts for at least 60% of ordinary business income; and 2) those firms engaged in production/processing and earns at least 60% of its revenues from the sale of its products to exporters.

(2) Two revisions were made to the bill. First, a surcharge of 0.25% was levied on all export and import transactions as a means of financing trade promotion bodies. Second, Philippine Export Foundation, Inc. (PEFI) and Confederation of Philippine Exporters (COPE) were integrated into one organization. In the end, however, both revisions were eliminated. In return, it was decided that contributions to exporter associations would be fully tax-deductible.

(3) The trade promotion functions of the DTI's International Trade Group (ITG) are scheduled to be privatized within two years from passage of this bill.

2) Five-Point Export Promotion Strategy

In April 1991, the DTI reexamined its medium- and long-term export plan and made a downward revision of its export target for the year 2000 from $35 billion to $20-25 billion. In addition, the 1992 target of $15 billion was lowered to $10 billion.

These revision were necessary because of the natural calamities and economic and social unrest that have followed since 1989, making it necessary to moderate heretofore the aggressive policy of emphasizing economic growth.

In the short term (1992-95), the DTI's new strategy will focus on resource-based export industries, reexamination of product development, assistance for new export corporations, and the development of markets for ethnic foods among Filipinos living abroad. The plan aims at annual export growth in the region of 15-20% and has set an export target of $10 billion for 1992.

The medium- and long-term plan (post-1995) places an emphasis on exports of high value-added products and works to promote high-tech products, exports under Philippine brand names, and the assistance and promotion of export champion industries and corporations. Target markets include Europe and the Asian-Pacific region, and the plan aims at diversification of export markets.

The five-point strategy is an attempt to promote these measures while taking into consideration the reexamination of the tariff structure (to be described below), rollback of the import levy, measures to allow export corporations to retain foreign exchange, and the proposal for structural revamping of DTI.

The philosophy behind the five-point strategy involves a fundamental reconsideration of past systems and policies such as the promotion of strategic industries, selective development of industrial location, expansion of export credit, guidance in product development, and manpower training.

The five-point strategy is summarized below.

1. Large exporters will be provided with assistance in terms of finances and improving the export environment, but companies are expected to carry out their own marketing activities and maintain high productivity.

2. Efforts will be made to maximize export production capacity at medium-sized exporters with annual sales of $1-10 million having potential for growth. Operating handicaps will be removed and assistance provided in the effective management of resources.

3. Small and medium-sized firms engaged in indirect exports will be given assistance in reducing operating costs, collecting of small cargo, and minimizing risk. Subcontractors will be classified according to region, industry and product and helped in the direction of export development.

4. The abundant raw materials and skilled labor of the Philippines will be mobilized and incentives given to export champion industries capable of maintaining marketability and high supply capacity.

The industries and products eligible for incentives are as follows: (1) shrimps and prawns; (2) gifts, toys and housewares; (3) consumer electronic equipment (including electronic products); (4) wiring harness; (5) service-related goods (computer software, film animation, etc.); and (6) music tape.

5. Improved image for Philippine products

Efforts will be made to improve the image of Philippine products by raising the quality of products and services, and sales channels for Philippine brand products will be developed on the international market.

3) Review of the Tariff Structure

Executive Order No. 470, calling for partial revision of the import duties listed in the Tariff and Customs Code of 1978, took effect on August 24, 1991.

This involved a review of the tariff structure as part of trade promotion policies and covered approximately 80% (6,193 line items) of the products listed in the 1978 tariff schedules. Revised tariffs will be applied to approximately 90% of these, or 5,561 items.

Tariffs range from 0% (duty-free) to 50%, and the revised system will be gradually phased in during a five-year period from August 1991 to July 1995. According to estimates by the Tariff Commission, import duties will be effectively reduced by 53.5% over the five-year period.

The aim of the government was to simplify a complicated tariff system, set consistent tariffs for related items, and revise the overly protective tariff structure. Although protective tariffs will not be altogether abolished, many of the import duties will be rolled back to cultivate competitiveness on the international market. From the consumer standpoint, the government also believes that the revisions will have a positive effect on the liberalization of trade by providing a supply of low-cost, high-quality materials and parts. This is thought to satisfy the conditions indicated by the IMF and World Bank.

In the 1978 tariff schedules, import duties ranged from 0% to 100%, with most products falling between 25% and 75%.

For those items which were not listed in Executive Order No. 470 or whose tariffs will not be revised, the classifications and tariffs given in the 1978 schedules will remain standing.

Export-related industries predict that the tariff revisions will have little effect in the short run, since these firms are already taking advantage of tax refunds and bonded warehouses. In the long term, however, there should be some effect. For example, replacement of imports with locally produced goods will result in lower procurement costs for materials and semi-finished goods. However, some industry sources such as upstream firms in the textile industry have suggested that the five-year phase-in period is too long and that three years would be sufficient.

4) Reduction of the Import Levy

Starting in mid-August 1991, the 9% import levy was cut to 5%, with the exception of a few items such as petroleum.

This surcharge was levied on all import transactions as a means of compensating for the huge fiscal deficits faced by the country.

The measure was proposed by the Department of Finance and was implemented in December 1990. It also happened just as the IMF and World Bank were about to give strong recommendations for a balanced budget. However, introduction of the levy resulted in higher prices for imported raw materials and various products, damaging the international competitiveness of the export sector. Moreover, there was an across-the-board reduction in import transactions, and industrial investment was also adversely affected. Strong criticism were heard from the private sector, and ultimately the government moved to reduce the tax. A source of replacement revenue has yet to be found, but the government has indicated that it will completely phase out the levy by June 1992, when President Aquino's current term is completed.

5) Retaining of Foreign Exchange by Export Corporations

In December 1991 the government increased the retention ratio of export-earned foreign currency earned by foreign corporations from 2 to 40 percent. In April 1992 it also abolished restrictions on its use.

6) Export Advance Program

In April 1992 it became possible for service exporters, not just exporters, to take out low-interest loans in pesos from Foreign Currency Deposit Units (FCDU) at commercial banks.

The loan amount is limited to 70% of the amount specified in the letter of credit or purchase order/sales contract, and must be repaid after the completion of each shipment.

Interest rates are reportedly in line with international levels (Central Bank Circular No. 1262).

3-3 Proposal for Revamping the Department of Trade and Industry

1) Reorganization of DTI

In April 1991 the Secretary of Trade and Industry submitted to the president a bill which would merge the Department of Trade and Industry with the Department of Tourism to form the Department of Trade, Tourism and Industry (DTTI). The various offices would be consolidated into three divisions -- trade, industry and tourism -- each having its own undersecretary and assistant secretary.

Also proposed was the merger and privatization of related government agencies for both Departments.

The goal of these reforms was to provide a more effective range of services to the private sector, promote further expansion and diversification of trade, achieve product distribution and stable supply throughout the country, and increase tourism investment and improve the industrial infrastructure. Other objectives were the promotion of small and medium-sized businesses and the development of tourism-related service industries.

2) Establishment of a Council

Under the new Department, the council chaired by the President will be established to give direction to the Philippines for its local and overseas activities in the three fields. Council members will include the Secretary of Trade, Industry and Tourism (serving as vice-chairman), the Director of General of NEDA, the Finance Secretary, the Governor of the Central Bank, and four representatives from the private sector.

3) Reorganization of ITG

The International Trade Group (ITG) will be reorganized as shown below.

1. Bureau of Foreign Trade and Economic Relations

The Bureau of Export Trade Promotion (BETP) and Bureau of International Trade Relations (BITR) will be consolidated, the International Coffee Organization Certifying Agency (ICO-CA) and Philippine Shippers Council (SHIPPERCON) will be absorbed therein, and international trade-related bureaus will be reinforced.

2. Foreign Trade Service Board

The Foreign Trade Service Corps (FTSC), comprising officers with experience abroad, will be reorganized into the Foreign Trade Service Board.

3. Garments and Textile Export Board (GTEB): To be continued as-is

4. Privatization of ITG Group Agencies

The powers of the president shall be used to privatize some or all of the functions and facilities of the following four agencies during the next five years:

• PTTC (Philippine Trade Training Center)
• CITEM (Center for International Trade Expositions and Missions, Inc.)
• PDDCP (Product Development and Design Center of the Philippines)
• PITC (Philippine International Trading Corporation)

5. The following two local commerce and industry-related bureaus will also be reorganized.

• Bureau of Domestic Trade and Consumer Protection
• Bureau of Products Standards

Note: Although the bill to revamp the DTI has been submitted to the House of Representatives, the President has not issued authorization for urgent consideration of the bill. As of November 1991, a legislative version had not been prepared, and public hearings had yet to be convened.

3-4 Trade Imbalance

Both exports and imports in the Philippines demonstrated expansion after the Aquino government came to power. Although in 1991 imports fell on the previous year for the first time to the tune of 1.3 percent, the Philippines still suffers under a large trade deficit and rectifying the imbalance looks to be difficult.

Growth in exports began to fall after peaking at 23.7 percent in 1988. In 1991 the rate of growth of exports had fallen to 8 percent. Growth in imports peaked in 1987 at 33.6 percent and has been declining since then. In 1991 imports fell 1.3 percent, marking the Aquino administration's first minus growth in imports.

The trade imbalance is the result of structural factors such as imports of equipment and facilities, construction-related materials, and fuel that have accompanied improvement of the infrastructure and development-related investment. Another recent factor is the expanded demand for foodstuffs and other consumer goods that has resulted from the liberalization of imports. From 1990 to 1991, the slump in economic activity and the surcharge levied on imports reduced imports of investment-related capital goods.

Exports of non-traditional products such as electronic goods and garments grew noticeably, but during the past few years there has been little change in the variety of export items, suggesting efforts are needed in the development of new products.

Below is a list of problems for individual export items.

Electronic goods: Labor-intensive component assembly for multinational corporations. Although contribution to the generation of the employment opportunities are high, added value remains insignificant.

Garments: Approximately 80% of all exports are heavily dependent on imported raw materials. In terms of management, the Philippines are attractive because of low labor costs, but added value is limited.

Fruits and marine products: Exports are focused around those items involving relatively little processing, such as fresh fish and frozen goods. More R&D is needed in the area of processed foods. The country also lags behind in quality control for seaweed products.

Copper and metal products: Linkage with production of the final product is important, and at present firms are easily affected by international price fluctuations.

A breakdown by major countries and regions shows that 85% of exports went to the ten leading destinations, with the United States and Japan alone accounting for about 55% of all shipments. In the future, export markets should be diversified, with efforts made to develop markets like the EC, ASEAN, Oceania, and the Middle East region.

Table II-3-1: Philippine Trade (1985-91)

	Exports		Imports		Balance
	$ million	Change over previous year (%)	$ million	Change over previous year (%)	$ million
1985	4,628	-14.1	5,110	-15.8	-482
1986	4,841	4.6	5,043	-1.3	-202
1987	5,720	18.2	6,736	33.6	-1,016
1988	7,074	23.7	8,159	21.1	-1,085
1989	7,820	10.5	10,418	27.7	-2,598
1990	8,186	4.7	12,206	17.2	-4,020
1991	8,839	8.0	12,052	-1.3	-3,213

Source: DTI statistics

Table II-3-2: Philippine Exports by Country and Region

(Unit: Millions of dollars)

	1989		1990		1991		
	Value	Share	Value	Share	Value	Share	Change over previous year (%)
U.S.	2,946	37.7	3,095	37.8	3,144	35.5	1.6
Japan	1,591	20.3	1,622	19.8	1,642	18.6	1.2
EC	1,326	17.0	1,449	17.7	1,448	16.4	0.0
ASEAN	532	6.8	585	7.1	617	7.0	5.5
Middle East	124	1.6	131	1.6	149	1.7	13.7
Subtotal	6,519	83.4	6,882	84.0	7,000	79.2	1.7
Total exports	7,820	100.0	8,186	100.0	8,839	100.0	8.0

Source: DTI statistics

Table II-3-3: Major Philippine Exports

	1989		1990		
	(FOB $ million)	Share (%)	(FOB $ million)	Share (%)	Change over previous year (%)
Electronic goods and components	1,751	22.4	1,964	24.0	112
Garments	1,575	20.1	1,776	21.7	113
Copper concentrates and copper metal	567	7.2	488	6.0	86
Coconut oil	377	4.8	361	4.4	96
Chemicals	279	3.6	261	3.2	94
Shrimps and prawns	231	3.0	219	2.7	95
Processed food and beverages	206	2.6	207	2.5	100
Furniture and fixtures	204	2.6	189	2.3	93
Petroleum products	95	1.2	155	1.9	163
Machinery and transport equipment	115	1.5	150	1.8	130
Bananas	146	1.9	149	1.8	102
Basketwork and wickerwork	134	1.7	128	1.6	96
Wood products	88	1.1	117	1.4	133
Centrifugal and refined sugar	89	1.2	111	1.4	125
Subtotal	5,857	74.9	6,275	76.7	107
Other	1,964	25.1	1,911	23.3	97
Total	7,821	100.0	8,186	100.0	105

Source: DTI statistics

3-5 Export Corporation Performance

In recent years, progress in government trade promotion policy has been accompanied by increasing enthusiasm towards exports from the private sector. According to a DTI study, the number of exporters grew to 6,395 in 1989, an increase of 1,128 over 1987.

Analysis of company size by export-related sales showed that 86.2% of the firms (only 9.1% in terms of total sales) posted annual turnover of less than $1 million, indicating a large group of thinly-capitalized small businesses.

758 of the firms had annual turnover of between $1 million and $10 million, an increase of 43% over 1987, while their share of total sales grew to 29.7%. Recently, the DTI designated these firms as "medium-scale export corporations with growth potential" as part of its new export promotion policies, and as noted above has hatched out a plan to expand production capacity at these firms. In a related development, the Bureau of Small and Medium Business Development (BSMBD) has proposed the need for the following measures for small and medium-sized business: (1) expansion of the credit framework; (2) supply and securing of raw materials; and (3) supply of marketing information and assistance in manpower training.

Table II-3-4: Profile of Philippine Exporters

Value of Annual Shipment ($1,000)	1987 No. of Exporters	% of Total number	% of Value	1989 No. of Exporters	% of Total number	% of Value
1,000 and less	4,627	87.8	9.6	5,513	86.2	9.1
1,000-10,000	531	10.1	28.1	758	11.9	29.7
Over 10,000	109	2.1	62.3	124	1.9	61.2
Total	5,267	100.0	100.0	6,395	100.0	100.0

Source: DTI survey

3-6 Trade Policy Recommendations

At present, the International Trade Group (ITG) of the DTI is mainly responsible for proposing trade promotion measures. As a nationwide bureau responsible for comprehensive planning, draft proposals, and trade promotion monitoring, however, it is rather vague and lacking in clarity.

The success of export promotion efforts will depend greatly on the economic and social policies of the government. Trade promotion and industrial development are two sides of the same coin, and the development of export industries and products will require full utilization of private sector vitality coupled with cultivation of international competitiveness throughout industry.

Following are several points concerning future promotion policy thought to require study and improvement.

1) Comprehensive Planning and Drafting of the Basic Measures

Judging from the current situation in the Philippines, a set of comprehensive, nationwide measures is needed to deal with improvement of the trade environment, development of foreign markets, and the assistance and promotion of export corporations.

In this sense, the Export Development Bill currently under consideration by the Congress clearly specifies proposed export promotion policies, a structure responsible for coordination, and individual bureaus. This is critical for any trade promotion policy, and it is hoped that the bill will be passed into law as soon as possible.

Although it appears quite possible that final passage of the bill through the Senate and House of Representatives will be delayed even further in light of the upcoming general election in May 1992, it is hoped that both private and public sectors will deepen their awareness of the urgency of trade promotion legislation.

Concerning economic and trade policy, it is important that there be no significant conflicts in opinion between government policies with government agencies. Particularly in the field of economics, closer links are needed between the Department of Agriculture, the Department of Environment and Natural Resources, NEDA, the Department of Finance, the Central Bank, the Department of Science and Technology, the Department of Transportation and Communications, and the Department of Trade and Industry. From the standpoint of giving priority to revenue supply, for example, the Department of Finance proposed an across-the-board levy on all imports, but the DTI opposed this plan because it would have an adverse effect on the promotion of trade and investment. Also, the DTI has proposed cutbacks in various taxes in order to promote investment, putting it in conflict with the Department of Finance. Concerning financial and foreign exchange policy as well, there have been numerous differences of opinion between NEDA and the Department of Finance and Central Bank.

In summary, understanding is needed between the government agencies responsible for planning and drafting comprehensive programs for economic and social development in the Philippines.

2) Improvement of the Export Environment

1. Work to create and expand a minimal industrial infrastructure for trade promotion -- ports, roads, and communications networks -- is urgently needed.

Even in Metro Manila, the installation of a telephone line can take upwards of one to two years from the time of application.

2. Simplification and Speeding Up of Export/import Procedures

Transport of raw materials and components from the airport to export processing zones (EPZs) is reported to take six days.

There are also many complaints concerning delays in customs processing of bonded fabrics, materials and components imported by sewing firms.

Numerous calls have also been made for the simplification of the procedures for foods, and further assistance is needed for efforts to introduce trade procedures in local areas outside the major cities.

3. At present most transactions are FOB, and CIF is seldom used. Trade promotion will require the raising of business standards to international levels. Systems to monitor export insurance, loading conditions, and shipping rates should be aggressively introduced.

The recognition of D/A terms (documents against acceptance) as well as L/C for exports has been well received as a step forward.

3) Diversification of Export Markets

The United States and Japan alone account for about 55% of all Philippine exports. In the future, it is recommended that Philippine exporters diversify their markets and work to increase shipments to the EC, ASEAN, and the Middle East.

This will require active participation in international exhibitions and trade fairs sponsored by CITEM and other organizations as well as the joint dispatch of sales missions and market research teams in cooperation with the private sector.

Furthermore, Philippine commercial attaches residing abroad should be mobilized to write reports on supply and demand and prepare prospective buyer lists for Philippine products in the target markets. The distribution of such reports to related industries would be very effective.

4) Assistance and Promotion of Export Corporations

250 out of the 6,400 export corporations in the Philippines, or about 4%, are responsible for fully 75% of total exports, suggesting that most of the export-related firms in the Philippines are small businesses.

For cottage industries and small businesses in particular, improvements in product quality are urgently needed. In this respect, the "image improvement" strategy newly announced by the DTI is of great value.

Improvements in product development and management will of course require funding. In this sense, the existing credit framework should be expanded, and assistance provided for "common service facilities" for joint use by small businesses.

5) PTTC and Trade Training Activities

The DTI's Philippine Trade Training Center (PTTC), established in 1987 as a JICA project in technical cooperation, has proven successful as a timely training program for people involved in export business. The purpose of JICA's Project-type Technical Cooperation is to contribute to the promotion of exports in the Philippines by offering advice to the in-house faculty of PTTC, its counterpart, by giving guidance and by developing human resources in the fields of trade and testing and inspection. It conducts these activities by way of dispatching Japanese experts, accepting Filipino trainees and supplying machineries and equipments.

Between when PTTC opened in 1987 and June, 1991, 368 lectures have been given (65 of those in regional areas) and auditors have totaled 15,000. Auditors have been comprised largely of management and employees from exporting and manufacturing firms and government employees in trade related fields.

The vision of PTTC is through its trade business training to nurture trade officials with a clear understanding of the global situation.

It was revealed as a result of analysis of the survey on training needs (a 1987 JICA/PTTC joint survey) that in industry and in trade in the Philippines there is both 1) insufficient knowledge and information about the international market, and 2) a lack of knowledge regarding trade business and marketing techniques. This situation has continued into the 1990s.

Thus PTTC training activities must continue to place emphasis lectures relating to 1) market trends of products, 2) cost analysis, 3) trade business and 4) production and technological management.

Among the proposed structural reforms to the DTI, however, are plans to privatize the PTTC. Although the schedule for the DTI reforms and privatization of PTTC and three other government agencies has yet to be announced, we would like to add a few comments concerning future activities and directions for PTTC.

1. Development of Training Courses in New Fields

The training programs of the PTTC play an important role in promoting exports, and this will remain so as long as there is a need for trade promotion.

Existing courses in marketing and testing & inspection (textiles, furniture and foodstuffs) need to be expanded.

For example firms must be made aware of the fact that 1) Philippines products and designs do not meet international standards and that 2) material and quality control systems in the production process must be thoroughly improved, and the present technology brought up-to-date.

In order to up these issues more actively, PTTC should provide new courses in product development together with instruction in process management and practical management skills (receiving of orders, sales contracts, corporate tie-ups, joint ventures and other mediation skills) in cooperation with related organizations. Furthermore, the need for training and guidance in local areas must be met.

2. Establishment of a Non-profit Foundation for PTTC Assistance

PTTC should also conduct training of faculty with expertise in areas of industrial standardization system development, and food hygiene control and export inspection in order to ensure smooth progress in these areas in the future. Moreover, if privatization becomes necessary, a non-profit organization should be established in order to support PTTC and under medium and long term plans, PTTC staff should be increased and its functions as well as its facilities augmented.

DTI sources say that the idea of creating a non-profit public organization to support PTTC training activities within the next one or two years has arisen. According to the idea, a tie-up with the private sector would be sought and funds raised through the issuance of capital stock for the building and facilities of PTTC, which are government assets, and operating profits through this would be used to support PTTC.

The fund is said to be on a scale of million of dollars. However a fund of $ 5 million would be required if the operating profits were to cover PTTC's current budget (around $740,000 per year) even if interest rate of around 15 percent were regarded as possible. According to a related source, it is expected that funds would be collected from foreign firms as well as domestic firms.

Table II-3-5: PTTC's Budget

Unit: 1,000 pesos

	Total value	Percentage of budget	
		Regular budget	Foreign aid funds
1988	17,223	46.4	53.6
1989	20,542	55.7	44.3
1990	20,260	63.0	37.0
1991	19,710	55.7	44.3
1992	20,327	61.6	38.4

Source: PTTC

Note: 1. Total value represents amount spent. Figure for 1991 represents budget and that for 1992 amount proposed.
2. At the end of October 1991, plantilla positions were 106 and filled-up positions were 73.
3. FAPs: Foreign Assisted Projects, financial support ceases once tie-up projects with foreign countries finish.

3. Utilization of PTTC Income

Miscellaneous income resulting from PTTC activities is on the rise. In 1990, 5 million pesos (equivalent to about $180,000, or 24% of the annual budget) was delivered to the national coffers.

The main sources of income were tuition fees for training seminars and rental fees for the exhibition hall and seminar rooms. Although the organization is authorized to retain tuition income to help cover operating expenses in the given fiscal year, all other earnings must be handed over to the government. It is therefore hoped that current regulations will be revised to allow PTTC to appropriate all earned income for operating expenses.

Furthermore, if PTTC moved into the consulting business, it could collect a variety of fees for its services. PTTC studio facilities could be used to produce materials, catalogs and films on export marketing under contract. Income could also be generated from the testing and inspection services which will be developed in the coming years.

4. Hiring and Improved Treatment of PTTC Faculty

The salaries for in-house faculty at PTTC are extremely low in comparison these individuals could expect in the private sector. Since contracts must be renewed each year, many of the faculty appear to have concerns about their livelihood.

At present, instructor salaries are paid by the Fund for Foreign Assisted Projects (FAPs), but the possibility of absorbing this into regular budget and instituting an across-the-board pay raise should be considered.

The authorization of faculty to receive fees for manuscripts or outside lectures or to moonlight as part-time instructors would be effective in retaining the existing staff and hiring new instructors.

4. Financial System for Promoting the Development of Sub-Sectors

(1) Recommendation on Financial System for Promoting the Development of Sub-Sectors

Following recommendations, which were made in the first year study report, on financing system for promoting the development of sub-sectors are basically applicable also to the sub-sectors studied in the second year. Namely, financial policies for the promotion of the selected sub-sectors must be examined from two viewpoints: 1) the raising of funds by large and medium-size businesses which will play a leading role in development of the sub-sectors: and 2) the raising of funds by the smaller businesses. The financial markets' capacity to raise and supply funds is quite limited and there is little prospect of an early improvement of this situation. Therefore, it is necessary to promote direct investment from overseas and direct loans from overseas financial institutions for large and medium size businesses. For small and medium size businesses, it is advisable to supply funds through institutional loan schemes by blending locally-sourced funds with low interest rate funds sourced through international cooperation. On top of this, it is necessary to support moves to provide supplemental means for the improvement of creditworthiness of each small and medium-sized business. What is most lacking in this regard is the absence of data regarding the credit standing of each business. In order to remedy this situation, it is necessary to : 1) use the accrediation and registration system applied to businesses as a substitute for data regarding the credit standing of each small and medium business: and 2) use information from industry associations and regional chambers of commerce and industry.

From this perspective, the following program recommendations for small and medium enterprises, are also applicable to the sub-sectors in the second year study, though some of them are under the stage of implementation trial in various forms.

1) Measures for Raising the Level of Credit of Small Businesses

a) The establishment of credit-rating criteria for loans for "qualified businesses" (businesses with excellent credit standing) and the application of preferential measures.

It is recommended that the preferential measures be applied to the excellent credit standing businesses which fulfill the required conditions, not only for the purpose of strengthening the creditworthiness of small and medium businesses, but also to provide incentives for self-improvement in the areas of technology, management, and marketing. These are : 1) relaxing loan screening criteria; and 2) securing a certain amount of funds for preferential loans.

b) Examination of establishment of a credit supplementaion system

It is recommended that the possibility of establishing a body with the function of supplying supplementary credit information on individual firms on the basis of the organization of industry associations or regional chambers of commerce and industry be studied. The information may be supplied by either a national body or regional units. At the same time, it is necessary to undertake a study of the feasibility of establishing a credit guarantee association which would base its activities on the information provided by the body recommended above. To minimize the risks involved in such system, it is recommended that insurance companies for credit guarantee company be established.

2) The Establishment of Loans for Sub-sector Modernization

Facilities in all of the sub-sectors under study are remarkably outdated, making the renewal and introduction of modern equipment a substantial problem. Due to insufficient financial and technological capability, used machinery is often purchased. Moreover, the machinery introduced is frequently inappropriate for the purposes of modernization.

It is recommended to set up a financing system which has a main objective of the solution of this and similar problems.

The needs for the above recommendation will become more urgent accordingly with increase in demand for new investment. At preset, the demand for financing is not great for each sub-sector, and the existing systems still have a capacity to absorb the further demand.

(2) Recent Development of Financing Programs for Small and Medium Scale Businesses

There is a development of financing program to assist the various types of economic development under the Window III of DBP. It includes,

1) Export Financing Program for the Philippine Chamber of Handicraft Industries (PCHI) and Foreign Buyers Association of the Philippines (FOBAP)

This is the financing program allocating fund for FOBAP and PCHI members, and a good example of credit supplementation through industry association for small and medium enterprises, which have insufficient credit capacity. This type of program may be applicable also to other sub-sectors.

The loan available by the program is up to 500,000 pesos without collateral, while the collateral is required for the exceeding amount. In the case of the program provided by TLRC, the maximum amount of loan available is limited to 70% of P/O or L/C. The interest rates also vary among the DBP and TLRC; 20.5% for the former, while 18% for the latter. Qualified borrowers are limited to the members of PCHI and FOBAP. Appraisal investigation is carried out not only by CIB (Credit Information Bureau), but also by PCHI through factory interview. The borrowers must submit their post dated check when the loan is disbursement.

The borrowers, as started in the above, are members of PCHI and FOBAP. The membership of PCHI is opened to those who are engaged in handicrafts industries either directly or indirectly. There are some industrial associations, including PHILTOY, which joins the PCHI as an association. The demand for financing is weak at present and amount of outstanding loan is small compared to amount available for the loan.

In the case of small and medium enterprises, they are often unfamiliar with the loan application procedure. It is recommended for the industrial associations to assist their members in the loan application as one of their activities. PCHI is collecting the loan processing fees at 2% of loan amount, and this can be utilized as a fund of activities of the association.

2) Others

Further, the Window III of DBP has a possibility to develop financing programs focusing on specific sub-sector promotion.