

Medalla, Erlinda M.; Austria, Myrna S.

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Philippine Institute for Development Studies

A Study on the Trade and Investment Policies of Developing Countries: The Case of the Philippines

Myrna S. Austria and Erlinda M. Medalla

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For comments, suggestions or further inquiries please contact:

The Research Information Staff, Philippine Institute for Development Studies

3rd Floor, NEDA sa Makati Building, 106 Amorsolo Street, Legaspi Village, Makati City, Philippines

Tel Nos: 8924059 and 8935705; Fax No: 8939589; E-mail: publications@pidsnet.pids.gov.ph

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A Study on the Trade and Investment Policies of Developing
Countries: The Case of the Philippines¹

Myrna S. Austria

and

Erlinda M. Medalla

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The authors are Research Fellow and Senior Research Fellow, respectively, at the Philippine Institute for Development Studies, Makati, Philippines. They wish to acknowledge the research assistance provided by Ms. May U. Coronado and Ms. Edith Lavina.

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Chapter 1

Introduction

Industrialization has been a major development goal for the Philippines since its independence, yet the pace of industrialization has been slow by comparison with the country's neighboring countries, particularly the ASEAN. The country has in fact undergone several trade and investment policy regimes in its pursuit for industrialization. In the 1950s and 1960s, the country was a classic case of the 'import substitution syndrome' based on the expansion of consumer goods production for the domestic market behind high protective walls, giving rise to import-dependent, inward-looking and capital intensive industries and an oligopolistic industrial structure characterized by unrealized scale economies.

In the 1970s and 1980s, attempts towards the promotion of exports were made when the goal of industrialization was not achieved. Reforms were made but the underlying weaknesses of the economy were not resolved. Unable to keep pace with the fast growing economies in the region, there were mounting pressures, both from internal and external sources, for the country to undergo industrial restructuring. Hence, in the late 1980s up to the 1990s, the country finally opted to adopt policies to shift to an outward orientation by unilaterally liberalizing trade, foreign investment and the exchange rate.

The recent developments in the regional and international arena pose several challenges for the Philippine government. The trend in the 1990s and beyond is to go global

as a result of the more liberalized trade and investment environment prompted by the formation of the GATT/WTO and the regional trading blocs like EU, APEC, AFTA and NAFTA. Trade and economic relations between and among member economies of these trading blocs are governed by agreed guiding principles and objectives. APEC for example advocates free and open trade and investment as one of its trade and investment policy priorities. The country is therefore challenged to affirm its commitment to liberalization and deregulation in order to take advantage of the opportunities that lie ahead as a result of the movements towards the globalization of the trade and investment environments.

A new approach to development cooperation is also evolving in line with the guiding principles of APEC. It is no longer based on North-South relations nor transfer of resources from developed to developing countries but on the pooling of resources among the member economies. These resources include not only financial resources but also expertise, information, experience and technology.

Objectives and Organization of the Study

The objectives of this study are threefold, namely (1) to analyze the trade and investment policies of the Philippines and how they have affected the growth and structure of the economy; (2) to analyze the effects of the country's trade and investment policies on the performance of manufacturing companies; and (3) to analyze the trends of the Philippine - Japan economic relations focusing on trade, investments and development assistance and

indicates some possible directions regarding the future role of Japan in Philippine development.

Chapter 2 reviews and analyzes the evolution of the trade and investment policies of the country with emphasis on how these policies have affected the economic growth and structure of the country. Trade and industrial policies have played a major role in setting the structure of the country. They influence relative prices and hence the allocation of resources and pattern of production. In particular, the biasedness they create in favor or against particular sectors or industries affects the efficiency with which resources are used. Likewise, the role of the exchange rate and monetary policies for selective industrial promotion is also discussed.

Chapter 3 presents the results of a case study on how a few selected manufacturing companies have responded to the changes in the country's trade and investment policies. The strategies adopted by the companies in strengthening their competitiveness in the light of the changes in the international trade and investment environments and their future prospects with the emergence of the regional trading blocs are discussed.

Chapter 4 examines the trends of the Philippine - Japan economic relations focusing on trade, investment and development assistance. The concerns arising from the trends and the future prospects in these three areas are analyzed in the context of the globalization of trade and investment and the new stance by which development cooperation among the APEC economies is taking shape.

Chapter 5 contains the summary and some general conclusions.

Chapter 2

Philippine Trade and Investment Policies

Trade and investment policies have been the major policy tools which shaped the Philippine industrial policy. Trade policy made liberal use of tariffs and import licensing requirements to protect local industries. On the other hand, the Philippine investment policy, basically set within the investment incentive system and the foreign investment act, promoted selected industries through the granting of fiscal incentives. The other policy measures which have had a major influence on industrial performance include the exchange rate and the use of monetary policy instruments. This part of the paper traces the policy development in these policy areas and the possible impact on Philippine industries.

As such, the section that follows discusses the evolution of Philippine trade policy and assesses what the impact has been on the overall protection structure. The Philippine investment system, particularly the Omnibus Investment Code is discussed next. The section also briefly goes over other export promotion measures, industrial estates, and foreign direct investment. This is followed by a separate discussion on the role of Philippine exchange rate policy and monetary policy. The final section is added to look at the resulting Philippine trade structure and trend, due to a large part to these policies.

The Philippine Trade Policy Regime

Trade policy is perhaps the most dominant factor influencing Philippine industrial policy. Its nature and impact have been well studied (Power and Sicat, 1969; Bautista, Power and Associates, 1979; Medalla and Power 1986; Medalla 1990; and Medalla et al, 1995). By and large, the Philippines has employed a restrictive trade regime, mainly to promote import-substituting industries starting as early as the beginning of the 1950s. There were short periods of decontrol in the 1960s, but on the whole, the trade protection bias has persisted for decades. It was only in the 1980s when major trade reforms began to be undertaken.

In general, the Philippine trade policy reform experience could be grouped into five periods. The first is the post-war period up to the 1970s covering the pre-reform era of highly trade-restrictive and protectionist policy regime, supporting the inward-looking import-substitution strategy at that time. This is followed by the first major trade reforms during the first half of the 1980s -- the 1981-85 Tariff Reform Program which brought down all tariff range to within 50 percent from highs of 100 percent tariff rates. The third period saw the major import liberalization episodes in 1986-88, soon after the EDSA revolution and under the Aquino Administration. The fourth period is the second phase of the Tariff Reform Program narrowing down the tariff range to mostly within 30 percent. This was implemented by the Aquino Administration under Executive Order 470 (EO 470) over a five-year period from 1991 to 1995. Finally, the fifth major period is the period covered by EO 264 implemented by the Ramos Administration over five years from 1996 to 2000. This further narrows down the range to within 3 and 10 percent (excluding some agricultural products).

Historical Evolution of Philippine Trade Policy

Before trade reforms started to be undertaken in the 1980s, the Philippines adopted a restrictive trade regime, mainly to promote import-substituting industries, starting as early as the 1950s. Moreover, the pattern of protection has been highly uneven, brought about by escalating tariffs (i.e. high for finishing stages and lower for lower stages of production) reinforced by a similar pattern of quantitative restriction (mainly in the form of import licensing requirement). Generally, there was very high effective protection for finishing/assembly types of operation, low protection for intermediate and capital goods production and negative or zero protection for the export sector. As such the past trade policy regime created serious distortions and biases which became deeply embedded after more than three decades of such protection system. It was only in the 1980s when major trade reforms began to be undertaken.

The restrictive trade policy adopted by the Philippines for more than three decades imposed serious distortions which prevented the efficient functioning of the market and resource allocation. First, by limiting the demand for imports, the protectionist trade policy defends an artificially cheapened foreign exchange. Thus, while a restrictive trade regime protects domestic industries in the domestic market, it simultaneously penalizes, in effect, domestic industries competing in the world market with the artificially cheapened foreign exchange. Then, by raising the (protected) price of the output, protection eventually becomes an impediment to forward linkages. Furthermore, with the escalation of tariffs and import controls, a capital-intensity bias is created and backward linkages are weakened. This results because capital and intermediate inputs, which come in at relatively lower tariffs --

usually lower than by how much foreign exchange is cheapened by protection-- are effectively cheaper than their world price.

These adverse effects are aside from the dynamic costs of protection in terms of possible efficiency losses and the lagging behind of our industrial sector compared to that of other countries with the absence of foreign competition. Such losses may even be the more serious legacy of a long-running protectionist regime. With inadequate exposure to the world market, the Philippines would lack the experience to deal with its intricate nature and lose out to the other more mature world traders.

Neither had the restrictive trade regime been able to provide a real solution to the BOP problems. Artificially making certain import substituting industries relatively more profitable through tariffs and QRs automatically has made potentially profitable exports less attractive. Scarce resources were induced to flow towards the protected sectors, leaving less resources for the potentially more profitable export sector. And since the cost of saving foreign exchange at the margin, under a protectionist regime, was much greater than the cost of producing foreign exchange (as previous studies have shown), improving the trade balance under such conditions has been more costly and difficult.

These bad side effects are borne out by the poor performance of the industrial sector after three decades of protection. Although the share of manufactured exports grew, they remain highly concentrated (in garments and semi-conductors). And the economy experienced recurrent BOP problems.

Recognizing more fully these adverse effects of past policies, the government started to undertake the first major trade reforms. These trade reforms, which began in 1981, contained three major components: (1) the 1981-85 Tariff Reform Program (TRP), (2) an import liberalization plan, and (3) the indirect tax realignment. The TRP proceeded as planned. The indirect tax realignment scheme, envisioned to remove the protective effects of differentiated sales tax between imports and local products, was implemented in the latter part of 1985. The import liberalization component was shelved in view of the balance-of-payments crisis in August 1983.

The move toward greater trade liberalization started in the 1980s with the passing of the 1981-85 Tariff Reform Program is considered among the most basic reforms to attain overall efficiency and sustained economic growth. By ridding the market of distortions, trade liberalization would espouse greater reliance on the market, foster competition, and provide an even playing field which would induce to reveal and encourage to develop industries with real comparative advantage. The 1981-85 TRP brought down all the tariff rates to within the zero-to-50 percent range, reducing substantially both the average tariff and the variation in tariff protection across industries.

The Aquino administration implemented more trade reforms reducing import restrictions (mainly in the form of import licensing requirements or outright import ban) from 1986 to 1989, and narrowing the tariff range with the implementation of EO 470. From 1986 to 1989, import restrictions on some 1,471 PSCC lines were lifted. This reduced the number of regulated items as a percentage of total number of PSCC lines from around 34.1 percent in 1985 to only 8.0

percent by the end of 1989. From 1989 to 1990, there was practically a lull in trade reforms when the country experienced severe difficulties caused by the December 1989 coup attempt, the oil price hike resulting from the Gulf war and a series of natural disasters. A few more items have been liberalized since then, bringing down the percentage of regulated items to less than 5 percent. (Table 2.1)

Table 2.1. Quantitative restrictions on imports, Philippines : 1980-1993

YEAR	Number of QRs (end-year)	Percent Change (per annum)	Percent of Import Items Subject to Restriction	Import Restricted Items as Percent of Total Imports
1980	2,901	---	51.8	---
1981	2,638	-9	47.1	33.0
1982	2,051	-22	36.6	35.2
1983	2,014	-2	36.0	34.7
1984	2,041	1	36.4	29.4
1985	1,967	-4	35.1	32.9
1986	973	-51	17.4	21.0
1987	802	-18	14.3	17.2
1988	579	-28	10.3	14.5
1989	20	-6	7.5	13.0
1990	447	-23	8.0	13.6
1991	291	-31	5.2	---
1992	126	-57	2.5	---
1993	183	45	---	---

Source : World Bank, 1993. World Bank Basic Economic Report, The Philippines: An Opening for Sustained Growth, Washington, D.C.
Updated by the Philippine authorities.

There were some tariff adjustments to cushion the effects somewhat of the removal of these import restrictions. The tariff changes, however, were generally temporary and minimal, resulting only in a slight increase in the average tariff. Then, the second phase of the tariff reform program started to be implemented with the passing of EO 470 in 1991. This further

narrows down the tariff range, with the majority of the tariff lines falling within the 3 to 30 percent range by the year 1995 (Table 2.2).

Table 2.2 Frequency distribution of tariff rates
(by number of H.S. lines)

Rate Level %	Pre-Reform*	81 - 85 TRP**		Pre-E.O. 470 1990	E.O. 470	
		1981	1985		1991	1995
Specific	2	2	2	0	0	0
0	1	3	3	33	45	43
3	0	0	0	0	277	285
5	2	14	14	42	11	16
10	319	380	334	1,635	1,589	1,957
15	0	0	0	0	3	26
20	204	282	335	1,273	970	1,036
25	0	0	0	0	30	19
30	218	194	284	1,226	978	1,971
35	0	0	0	7	0	0
40	5	87	100	544	485	0
45	0	0	0	2	0	0
50	203	151	331	1,431	1,173	208
60	0	59	0	0	0	0
70	119	139	0	0	0	0
75	0	2	0	0	0	0
80	0	58	0	0	0	0
90	0	29	0	0	0	0
100	228	2	0	0	0	0
Total	1,301	1,402	1,403	6,193	5,561	5,561

Source : Tariff Commission, August 1, 1991.

Notes: * P.D. 1464 Before TRP as amended by E.O. 521, P.D. 1500 and P.D. 1

**Up to and including E.O. 609, 632-A and 706.

Trade liberalization remains part of the Ramos Administration's policy agenda. This is enunciated in the Medium-Term Development Plan. Some of the earlier EOs and Central Bank Memos passed by the Ramos administration have been meant to liberalize trade further. This includes EO 1, EO 2, EO 5, EO 8, and EO 61 among the executive orders and CB Circulars

1347, 1356 and 1365 among the Central Bank Circulars. There has been some wavering in the implementation of these further trade reforms, with the suspension then revisions in executive orders and CB Circulars issued. Nonetheless, the intent to continue with the trade reforms remains, as manifested in the pronouncements and recommendations by the Tariff Task Force which is setting out to implement a lower and a more uniform tariff structure by the year 2003. Indeed, the first major step toward this has been undertaken with the passing of EO 264 which further narrows down the tariff range to within 3 and 10 percent by the year 2000.

Other Developments: The GATT-WTO, AFTA and APEC

The above discussion traces the evolution in Philippine trade policy which shows substantial unilateral trade reforms beginning in the 1980s. On top of these unilateral trends are multilateral movements toward greater global and regional liberalization especially in the 1990s. These include, most importantly, the ratification of the GATT-WTO (World Trade Organization), new initiatives under the AFTA (ASEAN Free Trade Area), and wider regional efforts to accelerate liberalization further under the APEC (Asia-Pacific Economic Cooperation).

The GATT-WTO

As a result of the GATT-WTO, the Philippines committed to bind tariffs on 2800 industrial tariff lines. This represents 50% of its total tariff lines. The bound rates are, however, ceiling rates of 10 percentage points above the 1995 applied rate and would not actually reduce existing tariff rates except for a few tariff lines.

The Philippine commitment to reduce tariffs affect only 24 tariff (industrial product) lines, all within the textile and clothing product group. This is less than 0.01% of our total tariff lines. The rates of absolute reduction range from 7.5 percentage points to 20 percentage points and will be effected over a period of ten years.

Product	number of tariff lines	applied rate 1995	bound rate 2004
Combed wool fabrics	12	30%	20%
Man-made fibers (synthetic and artificial monofilament)	3	20%	12.5%
Metallised and gimped yarns	2	30%	20%
Carpets(of wool, felt, man-made fibers, and polyamides)	7	50%	30%

In exchange for the above concessions, the Philippines received tariff concessions from our major trading partners. The GATT-WTO reduced overall tariffs across the board by at least 33%. The table below shows the percentage reductions on industrial products committed by our major trading partners. These industrial products had an estimated export value of US\$ 6.6 billion in 1992. This represented around 84% of total Philippine exports during the same year. On the average, the US, Japan, and the European Union have committed to reduce their tariffs by 35%, 56%, and 34%, respectively.

	US	JAPAN (in %)	EU
Total Industrial	35	56	34
Fish and Fish products	36	20	20
Wood, pulp, paper, and furniture	97	68	53
Leather, rubber, footwear, and travel goods	7	4	51
Metals	72	77	57
Chemicals and photographic supplies	47	63	37
Transport equipment	5	100	10
Nonelectrical Machinery	67	100	52
Electric Machinery	61	97	30
Mineral products and precious stones and metals	24	89	67
Manufactured articles, nes	64	81	41
Industrial tropical products	68	56	55
Plaiting products	23	36	46
Rubber, tropical wood	69	59	55
Jute and hard fibres	32	68	47

In view of the unilateral trade reforms the Philippines has implemented starting in the 1980s, not much further liberalization is effected by the new WTO. Instead, above anything else, the new WTO represents, for the Philippines, efforts to strengthening discipline and rules in the global trade and restore global trading order. It thus reinforces the current trend in trade policy. AFTA and APEC, on the other hand, within their narrower regional context, intend to achieve more in terms of reduction of trade barriers and lowering of tariffs.

The ASEAN Free Trade Area

The AFTA goes beyond the objectives of WTO and APEC, aiming to achieve a free trade area among the member countries. To this end, ASEAN has adopted the Common Effective

Preferential Tariff (CEPT) scheme. Under the scheme, a CEPT range of 0-5 percent is targeted over a 15-year period starting January, 1993. Plans to accelerate the schedule for liberalization within the bloc, in view of WTO and APEC, are being worked out.

The implementation of the CEPT follows two parallel schedules - (1) a normal rate of reduction (normal track) and (2) an accelerated rate of reduction (fast track). Under the normal track, products with tariff rates above 20 percent would be reduced to 20 percent within 5-8 years, then further down to 0-5 percent seven years thereafter. Products with tariff rates at 20 percent and below would be reduced to 0-5 percent within 10 years. Under the fast track, tariff rates would be reduced to 0-5 percent within 10 years for products with tariffs above 20 percent and within 7 years for those at 20 percent and below. Tables 2.3 to 2.6 give the Philippine general formula for tariff reduction.

The negotiations centered around which products to include in the normal track (inclusion list) and which to exclude in the tariff rate reduction (exclusion list). For the exclusion list, there are (a) general exception (for health and security reasons, patterned after GATT), (b) permanent exclusion, basically for raw agricultural products, and (c) temporary exclusion for "sensitive" industries which are deemed to need for time adjustment (Tables 2.7 to 2.8).

There is, at the same time, a fast track program for 15 product groups, which have been selected during the Fourth ASEAN Summit.

The 15 product groups for accelerated tariff reduction include vegetable oils (10 tariff lines), cement (7), chemicals (323), pharmaceuticals (19), fertilizers (25), plastics (68), rubber products (76), leather products (12), pulp (19), textiles (149), ceramics and glass products (69), gems and jewelry (39), copper cathodes (1), electronics (89), and wooden and rattan furniture (10), comprising a total of 916 tariff lines (8 digit HS code).

Table 2.3 Philippine general formula of programs for tariff reduction under the accelerated tariff reduction (Fast track)

For Products with Tariff Rates Above 20%

YEAR	EXISTING TARIFF RATES					
	21-25%	26-30%	31-35%	36-40%	41-45%	46-50%
1993) 1994) 1995)	During 1993-1995, Executive Order 470 Implements an autonomous 5-year tariff reduction program ending 1995					
1996	20%	25%	30%	35%	40%	45%
1997	20%	25%	25%	30%	35%	40%
1998	15%	20%	20%	25%	30%	35%
1999	15%	20%	20%	20%	25%	30%
2000	15%	15%	15%	15%	20%	25%
2001	10%	15%	15%	15%	15%	20%
2002	10%	10%	10%	10%	10%	15%
2003	0-5%	0-5%	0-5%	0-5%	0-5%	0-5%

Table 2.4 Philippine general formula of programs for tariff reduction under the accelerated tariff reduction (Fast track)

For Products with Tariff Rates 20% and Below

YEAR	EXISTING TARIFF RATES			
	0-5%	6-10%	11-15%	16-20%
1993) 1994) 1995)	During 1993-1995, Executive Order 470 Implements an autonomous 5-year tariff reduction program ending 1995			
1996	0-5%	0-5%	10%	15%
1997	-	0-5%	10%	15%
1998	-	-	10%	10%
1999	-	-	10%	10%
2000	-	-	0-5%	0-5%

Table 2.5 Philippine general formula of programs for tariff reduction under the normal tariff reduction (Normal track)

For Products with Tariff Rates Above 20%

YEAR	EXISTING TARIFF RATES					
	21-25%	26-30%	31-35%	36-40%	41-45%	46-50%
1993) 1994) 1995)	During 1993-1995, Executive Order 470 Implements an autonomous 5-year tariff reduction program ending 1995					
1996	20%	25%	30%	35%	40%	45%
1997	20%	25%	30%	30%	35%	40%
1998	20%	25%	30%	30%	30%	35%
1999	20%	25%	25%	25%	25%	30%
2000	20%	25%	25%	25%	25%	25%
2001	20%	20%	20%	20%	20%	20%
2002	20%	20%	20%	20%	20%	20%
2003	20%	20%	20%	20%	20%	20%
2004	15%	15%	15%	15%	15%	15%
2005	15%	15%	15%	15%	15%	15%
2006	10%	10%	10%	10%	10%	10%
2007	10%	10%	10%	10%	10%	10%
2008	0-5%	0-5%	0-5%	0-5%	0-5%	0-5%

Alburo (1993) estimates that a full participation in the 15 product groups would affect around 50 percent of total ASEAN trade and 15 percent of total Philippine trade. The initial product coverages in the fast track program for the Philippines, however would affect only 29 percent of the total Philippines trade with ASEAN or 7 percent of total Philippine trade (considering the less than full coverages for the Philippines in the 15 product groups at present).

More problematic is the exclusion list. If a product is included in a country's exclusion list, neither would the country be able to enjoy AFTA benefits for this product. The longer the exclusion list, the narrower the AFTA scope and its liberalizing impact.

Table 2.6 Philippine General Formula of Programs for Tariff Reduction
Under the Accelerated Tariff Reduction (Normal track)

For Products with Tariff Rates 20% and Below

YEAR	EXISTING TARIFF RATES			
	0-5%	6-10%	11-15%	16-20%
1993) 1994) 1995)	During 1993-1995, Executive Order 470 Implements an autonomous 5-year tariff reduction program ending 1995			
1996	0-5%	0-5%	10%	15%
1997	0-5%	0-5%	10%	15%
1998	0-5%	0-5%	10%	15%
1999	0-5%	0-5%	10%	15%
2000	--	--	10%	10%
2001	--	--	10%	10%
2002	--	--	0-5%	10%
2003	--	--	0-5%	0-5%

NOTE:

1) The above tables (2.3-2.6) are general tariff reduction formula. This does not preclude a faster or slower rate of reduction for each tariff line within the specified time-frame.

2) Starting date as at 1 January of the following year.

"Existing tariff Rates applicable to ASEAN:

Non-PTA products (as of 1 January 1992)

PTA products (as of 31 December 1992)

Table 2.9 gives the Philippine Exclusion List as of June, 1993. Of the tariff lines included in the temporary exclusion, garments comprise around 27 percent, food processing - 18 percent, paper - 9 percent and motor vehicles around 8 percent. To get full benefits from the AFTA, the exclusion list should be as short as possible. Exclusion should be limited to those for reasons of health and security.

Table 2.7 Summary of Philippine products excluded from the fast-track program

Product Group	No. of Lines
Vegetable Oils	20
Cement	--
Chemicals	20
Pharmaceuticals	2
Fertilizers	--
Plastics	6
Rubber Products	2
Leather and Leather Products	28
Pulp	--
Textiles and Textile Articles	271
Ceramic and Glass Products	30
Gems and Jewellery	11
Copper Cathode	--
Electronics	2
Wooden and Rattan Furniture	--
TOTAL	392

Table 2.8 Summary of Philippine products included under the fast-track program

Product Group	No. of Lines
Vegetable Oils	10
Cement	7
Chemicals	323
Pharmaceuticals	19
Fertilizers	25
Plastics	68
Rubber Products	76
Leather and Leather Products	12
Pulp	19
Textiles and Textile Articles	149
Ceramic and Glass Products	69
Gems and Jewellery	39
Copper Cathode	1
Electronics	89
Wooden and Rattan Furniture	10
TOTAL	916

As is inherent in any structural adjustment measures, the liberalization under AFTA is likely to have short-run adjustment costs. At the same time, the country would expect long-run dynamic gains from trade liberalization. On top of this is the positive impact, both in the short and the long run, of the reciprocal nature of trade liberalization among the member countries. This would mitigate to some extent whatever short-run costs would accompany reforms. Furthermore, this does not take into account the very likely positive impact of joining AFTA to the fullest extent of foreign direct investment. The more fully we implement AFTA, i. e. through a short exclusion list and large inclusion list in the fast track program, the greater the possibility of reaping these benefits.

Table 2.9 Philippine exclusion list

	No. of Items
<p>GENERAL EXCEPTION</p> <p>(products regulated for health and security reasons majority of which are arms and ammunition)</p> <p>TOTAL 1991 Import from the World = US \$ 10.7 M</p> <p>from ASEAN = 1.2 M</p>	= 28
<p>PERMANENT EXCLUSION</p> <p>(live animals, fish, vegetable products, crude animal/vegetable fats; oil and products thereof)</p> <p>TOTAL 1991 Import from the World = US \$ 475.4 M</p> <p>from ASEAN = 19.3 M</p>	= 398
<p>TEMPORARY EXCLUSION</p> <p>(garments sector; paper industry; food processing and motor vehicles under the car development program)</p> <p>TOTAL 1991 Import from the World = US \$ 1.1 B</p> <p>from ASEAN = 97.0 M</p>	= 675
TOTAL	= 1,107

Source : "Philippine Exclusion List in the CEPT-AFTA" presented by Undersecretary Cesar B. Bautista at PES/FES Seminar on AFTA, June 30, 1993.

The Asia -Pacific Economic Cooperation

More than anything, the commitment to APEC's goals set forth in the *Declaration of Common Resolve* signed in Bogor, Indonesia serves as a confirmation and reaffirmation by member economies to stay faithful to GATT-WTO principles and objectives of global liberalization. The APEC *open regionalism*, as conceived, is probably one of the best ways to ensure that countries uphold their WTO commitments. This intent is further enhanced and strengthened by efforts by the APEC to accelerate and deepen liberalization committed under WTO and achieve a free and open trade and investment regime by year 2020.

A major agenda that APEC is pursuing is technical cooperation which would gear member countries towards harmonization and facilitation. This is especially true in the area of customs procedures and standards. This would go a long way in facilitating trade within the region. The member countries were also required to submit a "down payment" on implementation of the Bogor pledges during the Osaka summit. On the part of the Philippines, the plan is to offer something in between what it committed to the WTO and what it has scheduled for AFTA.

All of these developments complement well the current policy thrust of the Philippine government. GATT-WTO, especially, would ensure that trading nations, especially the major industrialized ones, do not become more protective. This, together with the impact of AFTA and APEC, could open market access which would benefit greatly the export push strategy. In any

case, these developments ensure that the trends toward greater trade liberalization would continue, at least until the start of the next century.

Effects of Trade Policy Reforms

Studies under the PIDS Development Incentives Assessment (DIA) noted improvements in the tariff and protection structure brought about by the series of trade policy reforms. The average level of Effective Protection (EPR)¹ and the variation across industries has gone down significantly since the pre-reform period. Table 2.10 presents the average EPR across major sectors for the years 1983, 1985, 1990 and 1995 to illustrate more clearly the changes in the protection structure arising from the major trade reforms. As the Table indicates, the gap in EPRs specially between agriculture and industry, and between the exporting sector and the import-substituting sector has been significantly reduced.

More importantly, the project also provides empirical evidence on the positive impact of these trade reforms on competitiveness. The DIA Project shows that for the whole manufacturing sector, the DRC/SER (domestic resource cost as a ratio to the shadow exchange rate)² went down from around 1.7 in 1983 to around 1.5 in 1988, clearly an indication of an increase in the overall level of competitiveness of the manufacturing sector. To illustrate further,

¹The EPR is a measure of net protection considering the tariffs on both output and inputs. It is the percentage difference between "protected" domestic value added (value added given the tariff on both output and inputs) and free-trade value added (value added without tariffs).

²The measure of efficiency used in this project is the ratio of the domestic resource cost (DRC) to the shadow exchange rate (SER). The former indicates the value of domestic resources used to produce a unit of net foreign exchange while the latter indicates how society truly values foreign exchange. Thus, a ratio of one, or less than one, indicates efficiency since the activity is using domestic resources, whose cost is lower than value of the net foreign exchange it earned or saved. The lower the DRC/SER ratio, the higher the allocative efficiency.

Table 2.10 Effective Protection Rate (EPR), 1983,1985,1990& 1995
(Using book rates assuming without duty drawback), in per cent

Description	1983	1985	1989/90	199
03-96 All Sectors	44.2	38.0	29.4	24.1
Importables	87.4	76.0	57.0	47.0
Exportables	-4.0	-4.5	-1.4	-1.4
03-21 Agriculture, Fishing & Forestry	11.3	9.2	3.2	2.4
Importables	90.9	76.5	35.3	31.2
Exportables	-8.7	-7.8	-4.9	-4.9
03-13 Agriculture	24.2	19.5	9.8	9.4
Importables	88.4	76.4	31.7	30.4
Exportables	-4.4	-5.9	0.0	0.0
19-20 Fishing	8.1	9.2	6.0	4.4
Importables	103.2	79.7	48.3	35.0
Exportables	-5.4	-0.9	0.0	0.0
21-22 Logging & other Forestry Act.	-19.1	-19.7	-20.4	-21.0
Importables	75.9	58.2	41.7	24.7
Exportables	-22.8	-22.8	-22.8	-22.8
23-37 Mining	7.2	6.1	4.5	6.0
Importables	27.7	23.6	17.3	23.0
Exportables	0.1	0.1	0.1	0.1
28-96 Manufacturing	64.7	55.9	45.5	37.3
Importables	88.1	77.0	61.2	50.0
Exportables	3.1	0.1	3.8	3.8
28-45 Food Processing	66.6	57.8	46.2	38.3
Importables	86.5	76.9	60.3	49.9
Exportables	1.3	-4.8	0.0	0.0
46-50 Beverages & tobacco	64.1	54.9	51.5	50.6
Importables	120.8	103.5	97.1	95.3
Exportables	0.0	0.0	0.0	0.0
51-55 Textile & footwear	38.2	30.6	26.1	13.8
Importables	170.1	136.4	116.4	61.6
Exportables	0.0	0.0	0.0	0.0
56-58 Wood and wood prods.	18.0	18.0	29.4	29.4
Importables	0.0	0.0	0.0	0.0
Exportables	18.0	18.0	29.4	29.4

continuation... Table 2.10

59-66 Paper , rubber, leather & plastic prods.	194.4	142.1	113.9	89.2
Importables	230.1	168.3	134.9	105.6
Exportables	0.0	0.0	0.0	0.0
67-75 Chemical & products	126.0	102.1	71.1	51.4
Importables	126.0	102.1	71.1	51.4
Exportables	0.0	0.0	0.0	0.0
76-79 Non-metallic mineral prods.	38.4	38.3	39.5	39.9
Importables	38.9	38.8	40.0	40.4
Exportables	0.0	0.0	0.0	0.0
80-82 Basic metals & metal prods.	103.0	100.0	72.6	54.9
Importables	104.6	101.6	73.7	55.8
Exportables	0.0	0.0	0.0	0.0
83-91 Machinery incl. electrical & transport equipment	70.1	55.4	36.0	22.8
Importables	91.1	72.0	0.0	29.7
Exportables	0.0	0.0	0.0	0.0
92-96 Miscellaneous Manufactures	70.2	59.2	42.1	28.4
Importables	147.9	123.7	90.8	60.8
Exportables	5.3	5.3	1.3	1.3

Source : Tan, 1994

the share of establishments whose DRC/SER ratio fall within the range of zero and one (i. e., those with allocative efficiency) rose substantially between 1983 and 1988, in terms of both value of output and number of firms. In terms of value of output, the share of efficient firms increased significantly from 18.8 percent in 1983 to 39.5 percent in 1988. Furthermore, there was very significant correlation between the change in EPR and the change in DRC/SER between the two years.

The findings from the DIA study also shows evidence which points to a significant deconcentration of manufacturing industries taking place between 1983 and 1988 (Table 2.11). This is reflected in the sharp decline in the four-plant value added concentration ratio at the 3-digit PSIC level. Furthermore, the large majority of new entrants into industries were relatively small-scale plants. While the number of manufacturing plants increased by 63 percent from 1983 to 1988, employment grew by only 21 percent. This led to a significant decline in the average employment size of manufacturing plants from 125 to 92 workers per plant during the period. The compositional shift toward smaller plants served to reduce the large-scale bias of Philippine manufacturing industries, which presumably would have had positive employment and income distribution effects.

While the economy seems to be in the right track with respect to the trade policy direction, (which is perhaps the single most important factor in removing the overall bias against exports), the same could not be said with respect to the direction in the overall industrial strategy as embodied in its implementation of the investment incentive system. There appears to be contrary movements in the area of investment policy. The domestic-market orientation of BOI-approved projects is increasing. The next section focuses on this policy area.

The Investment Incentive System

The Philippine investment policy is largely embodied in the investment incentive system which has sought to influence investment activity through the granting of fiscal incentives to selected

activities, which is mainly administered by the Board of Investments. Other policy measures, such as the Foreign Investment Act, also has direct bearing.

Table 2.11 Manufacturing sector indicators

Manufacturing Sector Indicators	1983	1988	1988/1983
Manufacturing Value Added			
Current Prices	₱ 55,478 M	₱ 133,824 M	2.41
Constant 1972 prices	₱ 14,634 M	₱ 16,310 M	1.11
Real Imports/Real GDP*	12.59%	26.10%	2.07
Real Exports/Real GDP*	8.31%	22.63%	2.72
Manufactured Imports/Total Imports	62.00%	77.00%	1.24
Manufacture Exports/Total Exports	63.00%	72.00%	1.15
Number of Manufacturing plants	5,733	11,488	2.00
4-Firm Concentration Ratios	70	63	0.90
Total Number of Workers**	700,895	854,951	1.22
Workers per plant**	122	74	0.61
Census Value Added per plant*			
Current Prices	₱ 9.677 M	₱ 11.649 M	1.20
Constant 1972 prices	₱ 2.553 M	₱ 1.420 M	0.56
Census Value Added per Worker**			
Current Prices	₱ 79,153	₱ 156,528	1.98
Constant 1972 prices	₱ 20,879	₱ 19,077	0.91

* Price indices at 1985 base year

** Includes plants with 5 or more workers

Source : Medalla, Tecson, Bautista, Power & Associates, 1995. *"Catching Up with Asia's Tigers"*, PIDS, Makati. (Table 7.1)

Historical Background

Investment incentives have been available even as early as 1946. The earliest version offered exemption from all internal revenue taxes for a period of four years to "new and necessary" industries, the same set of industries the ensuing trade and exchange controls would protect. In the fifties, incentives in the form of liberal importation of raw materials and intermediate inputs were added. In the sixties, exemption from duties on imported equipment was made available to "basic" industries.

The system of investment incentives was formally institutionalized in 1967 with the enactment of the Investment Incentives Act of 1967. Priority areas were selected and "measured capacity" established for these areas. Incentives were geared mainly towards the production for the domestic market. They were additionally given further incentives in the form of tariff and/or import control protection (import licensing requirement or outright import ban).

In 1970, incentives were extended to nontraditional exports with the passing of the Export Incentives Act (RA 6135). Since then, the investment incentives act has been amended and codified three times, culminating with the Executive Order 226 or the 1987 Omnibus Investment Code (OIC). EO 226 superseded Batas Pambansa 391 (BP 391) which was passed in 1983.

The investment incentive system under the 1987 OIC (or EO 226) is administered by the Board of Investment (BOI). Only enterprises listed in the Investment Priorities Plan (IPP)

for a particular year, or an enterprise that would export at least 70 percent of its output could be eligible for incentives.

In the 1987 Code, incentives are uniform, with minor exemptions, for exporters and non-exporters. Both receive exemption from taxes and duties on imported equipment and accompanying spare parts. This represents a change in that previously, under BP 391 of 1983, non-exporters received exemption only as a temporary credit to be repaid out of tax credits earned later. Only exporters (producers exporting at least 50 percent of their outputs) were given an outright exemption under the 1983 Code.

The most important change in incentives, however, is the introduction of an income tax holiday to replace the tax credits on net value added for domestic producers and a higher percentage of tax credit based on net local content for exporters previously provided under the 1983 Code. Moreover, this income tax holiday is now available on the same terms to exporters and non-exporters under the 1987 Code. Pioneer firms are exempt from income tax for six years and non-pioneer firms for four years. Furthermore, the holiday can be extended to a maximum of eight years for pioneer and seven years for non-pioneer if certain conditions relating to capital intensity, use of local materials and foreign exchange earnings are met. A three year tax holiday is available for "expansion firms" -- i.e., existing firms that invest for expansion -- on income proportionate to the expansion.

Another new incentive is the deduction from taxable income of 50 percent of annual incremental labor expense for a period of five years. Since an income tax holiday is already

available for registered firms, such a deduction from taxable income is obviously redundant, except for the difference in number of years they are available. The deduction is available for five years, longer than that for the holiday which is four years for new non-pioneer firms and three years for expanding firms. Thus, the incremental labor expense deduction could be used during the fifth year by a new non-pioneer that for some reasons could not get an extension, as well as by expanding firms in the fourth and fifth years (no extension is available for this category).

Thus, the income tax holiday and the tax-free importation of capital equipment rank as the key incentives in the new Code. As already noted, these are uniform for exporters and non-exporters alike. This contrasts with the 1983 Code which explicitly aimed incentives at mitigating, if not overcoming, the bias against exports from the protection system. Thus the new Code, insofar as tax incentives are concerned, is virtually neutral between exporters and non-exporters. The duty-free importation of imported inputs serves as the only advantage of exporters which is available to all exporters, registered or not with the BOI.

While the incentives in the new Code have become more neutral with respect to exporters and non-exporters, they are now less neutral with respect to the choice between labor-intensive and capital-intensive industries and techniques of production. Two changes account for this. First, as noted above, registered firms may be granted exemption from taxes and duties on imported capital equipment and accompanying spare parts. This represents a return to the pre-1983 situation. Prior to the 1983 reform, a need for this incentive was argued by the BOI on the grounds of a liquidity problem for the investor. He can get credit for the import of the

equipment, but not for the payment of duty. This argument was met in the 1983 Code by letting the investor pay the duty and tax over time out of tax credits earned -- in effect, an interest-free loan. Hence, the reversion to the old system in the 1987 Code must have a different rationale.

The other change that implies a bias toward capital intensity is the substitution of the tax holiday for the tax credits on value added and local content. The latter were actually pro-labor in their bias, while the income tax holiday reduces the user cost of capital and encourages substitution of capital for labor.

Other Export Promotion Measures

Even prior to the trade reforms in the 1980s, the government has increasingly recognized the inherent bias of the then prevailing highly protectionist regime. To start with its efforts to promote exports, the government passed 1970 Export Incentives Act. Over time, the granting of incentives to exports were extended outside BOI.

Outside the BOI, there are other export promotion programs designed to at least grant exporters access to inputs at world prices. For example, tax and duty free importation of intermediate inputs and capital equipment could be availed of under various schemes such as:

- (1) locating in an export processing zone,
- (2) using bonded manufacturing warehouse (BMW) facilities, and
- (3) importing under Customs Administrative Order 3-78 (CAO 3-78).

Or, an exporting firm could avail of tax and duty drawback for intermediate inputs used in export production under the standard drawback scheme of the Board of Investment and the Bureau of Customs for certain specific products where standard rates (the proportion of exports to be granted duty drawback) have been computed. These schemes, in varying degrees, (including the BOI export incentives) are often found to be tedious and burdensome (Manasan 1990), owing mainly to the numerous signatures and documentary requirements. Major improvements have been achieved with the implementation of the one-stop shop for exporters, greatly reducing the time spent for incentives availment. Still, the procedures remain complex. These export promotion measures should be continually improved to (1) reach a wider coverage of new exports, and (2) increase the automaticity of the duty-drawback system. Efforts to streamline export procedures should be given priority. These include the greater application of the standard duty drawback and the more extensive use of common bonded manufacturing warehouse.

Promotion of Industrial Estates

The government is also implementing a mechanism for overcoming disadvantages in social and physical overhead for regions outside Metro Manila through the development of industrial estates. These are "large and suitable tract of land which has been subdivided and developed primarily for the use of a community of industries and provided with roads, water supply facilities, electrical facilities, communication facilities, sewage and drainage systems, and other infrastructures... under unified and continuous management." Industrial estates could be of two general types: the regular industrial estate (IE) whose products could be for export or

domestic consumption, and the export processing zone (EPZ) geared strictly for exports. Firms locating in the estates receive fiscal incentives.

The EPZ is more of an incentive to exporting and thus receive more generous incentives. These include (1) exemption from customs duties and internal taxes for capital equipment, raw materials and supplies, local taxes and licenses, except real estate taxes, contractor's taxes, wharfage dues and export tax, (2) deduction of labor training expenses, organizational and pre-operating expenses, (3) tax credits on supplies and raw materials, (4) net operating loss carry-over, and (5) accelerated depreciation. The firms in a regular IE receive similar incentives as in (1). They are also entitled to BOI incentives if eligible and registered. Results from past studies of the performance of IEs and EPZs are, however, not very encouraging (Louis Berger, Inc., 1986). These studies find that on the whole they have been very costly and ineffective instruments for regional dispersal of industries, which is largely attributed to the substantial unutilized capacity in the industrial estates. In the recent months, there are persistent signs of increased investment activities, both foreign and domestic, and increased capacity utilization in the various IEs. Hopefully, these would yield more favorable results.

Foreign Investment Policy

Foreign investment is generally welcome. They are eligible to the same investment incentives available to local firms. Before the 1992 Foreign Investment Act (FIA), however, their eligibility for 100 percent equity is subject to BOI approval. In general, this meant falling under some "positive" list the BOI considered the desirable areas for 100 percent foreign equity.

Box 2.1 provides some indication of the influences in the past FDI inflows. Aldaba (1994) finds that the fiscal incentives system was an insignificant explanatory variable. The most significant explanatory variables are (1) political stability and (2) the effective protection rate (EPR). In other words, foreign investments in the past was concentrated in the high protection import substitution sectors.

The 1992 Foreign Investment Act liberalizes entry and equity requirements of foreign direct investments (FDI) by providing instead a "negative" list of industries where 100 percent foreign equity is not allowed. Outside the set of industries in the Negative list, there are no limits on foreign equity participation. The use of a limited negative list for foreign investment is viewed as a major improvement in relaxing rules and regulations governing entry of FDI and encouraging more FDI inflows.

It is too early to judge what impact this has had on FDI flows, in terms of both the level and the type of investments attracted. There has definitely been an upsurge in FDI inflows in the past year but this could as much have been due to increased political stability. As Table 2.12 indicates, foreign direct investments to the Philippines more than doubled in 1994 to US \$796 M from US \$334 M in 1993. Hopefully, this would be maintain in the following years. What is more interesting to note is how the Philippines has fared in attracting foreign investments compared to its ASEAN neighbors -- Thailand, Indonesia and Malaysia.

Box 2.1**Foreign Direct Investment in the Philippines:
Some Findings**

Aldaba (PIDS Research Paper Series 94-10) provides some indications of the determinants and the type of direct foreign investment (DFI) attracted in the Philippines. In her regression analysis, she finds that the fiscal incentives system was an insignificant explanatory variable. The most significant explanatory variables are (1) political stability and (2) the effective protection rate (EPR). In other words, foreign investments in the past was concentrated in the high protection import substitution sectors. This is unfortunate because it is the DFI in exporting activities which are found to be most beneficial. Aldaba also estimated the export propensities of majority-owned non-bank affiliates of US parent companies (MONANUS) for a number of countries including the Philippines, Thailand, Indonesia and Malaysia. The export propensity for the Philippines is the lowest in the set in 1982, the high protection period, although only slightly lower than that for Thailand. The export propensity for Thailand rose sharply, reaching 31.8 percent in 1989. The propensity for the Philippines also increased in 1989, but more slowly, so that it remained lower than the rest.

Still, there was some improvement in the orientation of DFI, which coincided with the more open trade regime following significant reforms during the period 1986-88.

EXPORT PROPENSITY (%)

	1982	1989
Philippines	15.7	22.3
Thailand	17.5	31.8
Malaysia	47.4	38.5
Indonesia	66.1	43.8
Singapore	82.0	69.7

Table 2.12 FDI flows in four Asean countries: 1973-1993 (US\$ million)

Year	Philippines	Indonesia	Malaysia	Thailand
1973	83	15	171	77
1974	64	-49	570	188
1975	116	474	348	86
1976	91	343	380	79
1977	130	235	408	106
1978	60	219	466	51
1979	62	226	573	50
1980	75	179	933	186
1981	91	133	1,266	291
1982	25	226	1,393	190
1983	119	292	1,261	348
1984	32	222	797	400
1985	9	310	695	162
1986	17	258	489	261
1987	34	385	423	182
1988	81	576	719	1,081
1989	93	682	1,668	1,727
1990	171	964	2,332	2,402
1991	130	1,482	3,998	1,866
1992	234	1,777	4,469	2,017
1993	334	2,003	4,079	1,285
1994	796			
Average				
1973-91	78	377	994	437
1973-77	97	204	375	107
1978-82	63	197	926	154
1983-87	42	293	733	271
1988-93*	263	1,247	2,878	1,730

*For the Philippines, the average covers the period 88-94.

Source: Aldaba, 1994. "Foreign Direct Investment in the Philippines: A Reassessment", PIDS Research Paper Series No. 94-10, Makati, Philippine Institute for Development Studies.

ADB Key Indicators, 1994. Asian Development Bank.

In the 1970s, the Philippines did at least as well as Thailand in attracting FDI and was not too far behind Indonesia. Malaysia has been the clear front runner, receiving the bulk of the wave of FDI during the 1981-83 period. Thailand received the next wave of FDI flow from 1988-90. Malaysia has again been figuring well in the 1990s. Indonesia, on the other hand, has been attracting a steady increase of FDI flows. These trends left the Philippines well behind the ASEAN-4 in attracting FDI by 1990. Some signs of catching up could be discerned beginning in 1993. With major policy reforms in place and increased signs of political stability, this trend should hold in the future.

Effects of the Philippine Investment Incentive System

Looking at some statistics on BOI-approved projects provides some insights on the impact of the changes in the investment incentive system. The first major observation is the declining share of export-oriented firms in BOI-approved projects. Between 1983 to 1986 (the BP 391 era), export producers accounted for more than 70 percent of project cost. This went down to 25 percent in 1993 and further down to only 15 percent in 1994 (Tables 2.13 and 2.14). The figures are not as bad in terms of number of firms, where exporters still account for more than fifty percent, since exporting firms are much smaller in terms of project cost. Nonetheless, these figures show that the removal of the preference for exports, brought about by the change in the incentives system from BP 391 to EO 226, has impacted accordingly in the types of projects approved by the BOI.

Table 2.13 Percentage share in total project cost of BOI-approved projects, by type of producer (In per cent)

Year	Type of Producer			
	Agriculture	Domestic	Export	Others
1981	23.3	31.1	45.3	0.3
1983	6.4	68.4	25.2	0.0
1986	19.3	9.1	71.6	0.0
1990	0.0	26.8	26.0	47.2
1991	0.0	51.2	14.7	34.0
1992	0.0	37.7	21.6	40.7
1993	0.0	32.6	25.6	41.8
1994	0.0	34.0	14.1	52.0
Value in Million Pesos				
1981	2,650	3,534	5,151	30
1994	0	153,223	63,625	234,506

Source: Board of Investments. Department of Trade and Industry.

A relevant question is has the same bias resulted in the case of direct foreign investment. This appears to be the case. The trend in the distribution of foreign equity of BOI-approved projects replicates that of the distribution of project cost of BOI-approved projects over the period considered. In 1985, around 97 percent of foreign equity investments of BOI-approved projects are export-oriented. The share declined to around 40 percent in 1993 and further down to 21 percent by 1994 (Table 2.15).

Table 2.14 Percentage share in number of firms approved for BOI registration, by type of producer (In per cent)

Year	Type of Producer			
	Agriculture	Domestic	Export	Others
1981	21	17	61	1
1983	13	22	65	0
1986	14	4	82	0
1990	0	13	70	17
1991	0	16	72	12
1992	0	13	76	11
1993	0	16	70	14
1994	0	15	59	26
Number of Firms				
1981	40	34	118	1
1994	0	110	426	192

Source: Board of Investments. Department of Trade and Industry.

Note: Others include Service, Agricultural farm services, Infrastructure/ind'l service facilities, Public utilities, Export traders, Research and development activities, Energy-related projs., Tourism-oriented projs. and commerce.

From 1988-1994, agricultural producers are included in domestic producers.

Such a shift in orientation has serious implications in at least two areas. One, although exporting activities in terms of number of firms still account for more than 50 percent of total BOI-approved projects, protection to the export sector is effectively diluted. Giving substantial incentives to other (domestic oriented) activities runs counter to the objective of making exporting relatively more attractive. Second, the larger share in terms of project costs of domestic oriented BOI-approved project implies huge revenue foregone which has macroeconomic implications. Such revenue foregone from investment incentives to exporting could be justified (e. g., on externality grounds and distortions created by the trade regime.) The

same is not as clear in the case of domestic oriented projects. Indeed, the PIDS-DIA study shows that activities within the IPP appear to be more inefficient savers of foreign exchange, their DRC/SER ratio being greater than one and larger even than the average for manufacturing (Box 2.2) Faced with a budget constraint, limiting revenue foregone from investment incentives to domestic producers would be most prudent and judicious.

Table 2.15 Value and percentage share of foreign equity investments of BOI-approved projects, by type of producer

Year	Type of Producer			
	Agriculture	Domestic	Export	Others
Value (in Million Peso)				
1985	14	11	845	0
1986	53	12	277	0
1988	0	3,293	4,366	0
1990	0	2,698	8,566	6,885
1991	0	7,375	2,236	4,434
1992	0	1,521	1,993	2,083
1993	0	2,911	4,822	4,453
1994	0	20,209	13,074	28,004
Percentage Share (%)				
1985	1.7	1.2	97.1	0.0
1986	15.5	3.5	81.0	0.0
1988	0.0	43.0	57.0	0.0
1990	0.0	14.9	47.2	37.9
1991	0.0	52.5	15.9	31.6
1992	0.0	27.2	35.6	37.2
1993	0.0	23.9	39.6	36.5
1994	0.0	33.0	21.3	45.7

Source: Board of Investments. Department of Trade and Industry.

Note: Others include Service, Agricultural farm services, Infrastructure/ind'l service facilities, Public utilities, Export traders, Research and development activities, Energy-related proj's. Tourism-oriented projects and Commerce.

From 1988-1994, agricultural producers are included in domestic producers.

Box 2.2. Excerpt from PIDS-DIA Study on the Social Profitability of IPP Activities

"... One could, however, make some judgement about how optimally (or otherwise) the IPP has reallocated investments by comparing some measure of social profitability for those industries within and without the IPP. If those industries within the IPP prove more socially profitable, then at the very least, the IPP has had no adverse effect in resource allocation, and could very well even have led to a better investment allocation. Otherwise, it would be a clear indication of error, on the whole, in the selection of industries.

This was done for this study, using some rough estimate of the domestic resource cost (DRC) and some approximation of where the IPP activity belongs in the 5-digit PSIC classification of manufacturing industries. The DRC, which is the value of domestic resources used, in shadow prices (i. e., real scarcity value, or social value), per unit of net foreign exchange earned or saved, is taken as a ratio to the Shadow Exchange Rate (SER) to indicate comparative advantage. Results show that, using 1988 NSO establishment data from the census of manufacturing establishments, the industries included in the IPP have even higher DRC/SER — 2.3 for those industries including the IPP compared to only 1.5 for all manufacturing."

DRC/SER, EPR & BVP of projects included in IPP (1988)

	DRC/SER	EPR
Industries w/in IPP (1988)	2.3	35.6
All Industries (w/in & outside IPP)	1.5	28.3

Another interesting finding from the PIDS-DIA project is the estimate of the EPR for the activities within the IPP, compared to the overall average for the manufacturing sector. The EPR estimate coming from trade policy for activities within the IPP is relatively higher at around 36 percent, compared to EPR for the whole of manufacturing at around 28 percent. This implies that the investment incentive system tended, in general, to reinforce the bias of trade policy.

The next tables (2.16 to 2.17) show the distribution of BOI-approved projects by type of activity. In 1985, export manufacturing accounted for around 74 percent of project cost. This is down to only 13 percent in 1994. In contrast, domestic-oriented manufacturing went up from less than 1 percent in 1985 to around 33 percent in 1994. Within manufacturing, exporting electronic and electronic products accounted for more than half the share of total manufacturing projects approved by BOI in 1985. The share has gone down to only 11 percent of manufacturing projects. There appears to be a tendency for incentives to be highly concentrated in specific exporting activities. And the reach and coverage of incentives to exports is limited. Domestic market-oriented construction/housing components took the largest share of around 36 percent in 1994.

Another major observation is on the capital-labor ratio of BOI-approved projects. As shown in Table 2.18, the capital-labor ratio (K/L), which is estimated by the project cost divided by employment, fell drastically during the period from 1983 to 1986, when BP 391 was in effect -- ₱ 512,740 per employee in 1982 down to only ₱ 83,660 in 1986, both in nominal terms. (The decline is even more drastic using constant prices.) Since then, the figure for K/L continue to rise rapidly, reaching ₱ 1.27 million by 1993. The large differences clearly indicate the capital bias of the investment incentive system under the 1987 OIC vis-a-vis BP 391.

Table 2.16 Project cost of BOI-approved projects by sector
New & expansion projects, with incentives

	1986		1990		1994	
	PC (Mil. Pesos)	% Share	PC (Mil. Pesos)	% Share	PC (Mil. Pesos)	% Share
DOMESTIC	622	28.4	73,963	74.0	387,730	85.9
Manufacturing	184	8.4	18,828	18.8	148,879	33.0
Agriculture, Forestry & Fishery	423	19.3	768	0.8	2,353	0.5
Mining	0	0.0	7,193	7.2	1,936	0.4
Energy-related projects	16	0.7	23,420	23.4	118,037	26.2
Tourism-oriented projects	0	0.0	12,852	12.9	8,580	1.9
Public utilities	0	0.0	3,477	3.5	85,811	19.0
Others	0	0.0	7,425	7.4	22,134	4.9
EXPORT	1,569	71.6	25,932	26.0	63,625	14.1
Manufacturing	1,483	67.6	22,939	23.0	58,837	13.0
Agriculture, Forestry & Fishery	20	0.9	386	0.4	1,206	0.3
Mining	0	0.0	2,607	2.6	3,582	0.8
Energy-related projects	67	3.1	0	0.0	0	0.0
Tourism-oriented projects	0	0.0	0	0.0	0	0.0
Public utilities	0	0.0	0	0.0	0	0.0
Others	0	0.0	0	0.0	0	0.0
TOTAL	2,192	100.0	99,895	100.0	451,355	100.0

Source: Board of Investments, Department of Trade and Industry.

Note: Others include service, Agricultural farm services, Infrastructure/ind'l service facilities, Export traders, Commerce and Research and development activities.

Table 2.17 Percentage share in total BOI-approved project cost in manufacturing

	1986		1990		1994	
	Domestic	Export	Domestic	Export	Domestic	Export
TOTAL	11.0	89.0	45.1	54.9	71.7	28.3
Processed Foods	-	7.7	1.9	1.7	0.1	1.2
Wood and wood prods.	-	2.2	1.0	0.6	0.1	1.4
Paper & paper prods.	-	-	0.4	1.9	0.0	1.0
Textile & textile prods.	11.0	8.4	0.3	17.2	0.0	3.4
Other textile prods	-	0.6	-	0.7	0.1	0.1
Wearing apparel	-	7.5	-	1.3	-	0.3
Footwear	-	0.6	-	0.3	-	0.1
Leather & leather prods.	-	0.3	-	0.0	-	0.0
Chemical fertilizers	-	-	0.1	-	-	0.0
Basic ind'l. chem'ls.	-	1.7	3.8	0.4	7.2	2.0
Synthetic resins	-	-	-	-	9.1	0.0
Synthetic yarns & fibers	-	-	-	0.1	-	-
Drugs & pharmaceuticals	-	-	0.9	0.1	0.0	0.1
Misc. chem'l. prods.	-	0.6	2.0	0.2	0.2	0.1
Petroleum prods.	-	-	-	0.1	12.3	1.3
Rubber prods.	-	-	-	-	-	0.0
Plastic prods.	-	4.0	2.6	1.0	-	0.7
Non-metallic mineral prods	-	-	3.5	0.6	0.7	0.0
Construction/housing compo.	-	2.2	22.4	1.3	36.8	0.4
Basic metal prods.	-	-	4.6	-	2.9	0.8
Fabricated metal prods.	-	-	0.5	1.1	0.0	0.9
Machinery & equipment	-	0.1	0.1	1.7	0.2	0.1
Electrical & electronic prods.	-	40.8	0.1	11.2	1.1	11.4
Shipbuilding/repair/breaking	-	-	-	-	0.7	-
CVDP	-	-	1.0	11.5	0.1	2.5
PMMP/PCMP	-	10.3	-	-	-	0.0
Professional & scientific eqpt	-	-	-	0.1	-	-
Misc. manufactured prods.	-	1.8	0.0	1.8	-	0.3
Printing & Publishing	-	-	-	0.0	-	0.0
Aircraft & components mfg.	-	-	-	-	-	-
Other products	-	0.2	-	0.1	0.0	0.0

Source : Board of Investments. Department of Trade and Industry.

**Table 2.18 Capital labor ratio of BOI-approved project,
by type of producer (In thousand pesos)**

Year	Type of Producer			
	Agriculture	Domestic	Export	Others
1981	249	378	156	254
1983	175	782	100	0
1986	198	844	66	0
1990	0	2,240	308	2,756
1991	0	4,888	233	4,777
1992	0	3,700	211	7,816
1993	0	3,514	399	8,051
1994	0	7,903	712	6,374

Source: Board of Investments. Department of Trade and Industry.

Note: Others include Service, Agricultural farm services, Infrastructure/ind'l service facilities, Public utilities, Export traders, Research and development activities, Energy-related projs., Tourism-oriented projs. and commerce.

From 1988-1994, agricultural producers are included in domestic producers.

Some weaknesses in the incentives provided have been noted earlier and in the PIDS-DIA study. One major conclusion is that the key incentives of the OIC -- income tax holiday and tax-free importation of capital equipment -- have reintroduced the bias toward capital-intensity. Moreover, the income tax holiday incentive will not benefit much those enterprises that need help, possibly incurring income losses in the early years (which is likely to be the case for many new enterprises). Rather the principal beneficiaries will be those enterprises that are amply profitable from the outset and, therefore, might not have, in the first place, needed incentives.

What seems more critical, however, is the selection of activities to be included IPP, which is becoming more geared towards the domestic market. Aside from the removal of preference

for exporting activities effected by the change from BP 391 to EO 226, the selection process for IPP inclusion itself, deliberate or not, may have been directly a factor in such a change in orientation. The process appears ad hoc. A firm applies for inclusion in the IPP and BOI incentives for a certain activity. The BOI reviews the application and decides for the inclusion or rejection. Although the evaluation criteria could be objective, such an ad hoc system could only be a fragmented and weak means of carrying out the ideal role of investment incentives. This is manifested in the large number of activities included in the IPP. In 1989, there were 234 investment areas included. This went down to 60 in 1994- still a large number of areas.

Clearly, there is a need to rationalize the investment incentives system for it to serve its ideal role. The rationale for the investment incentive system is not to induce additional investment in itself. This, if needed, is the responsibility of the overall fiscal and monetary policy. The objective is to channel investments to the desired sectors within industry which will maximize the potential of the industrial sector in the development process. Basically, this means providing investment incentives which will correct for market failures and distortions which prevents such optimal flow of investments.

The most recognized market failures include the presence of externalities, economies of scale, imperfect capital markets. However, what has turned out to have caused the more serious distortion is the protection system. As discussed in the previous section, much progress has been made to reduce the distortion through the various trade reforms implemented. Still, there remains some bias against exports from the protection system which the investment incentive system should continue to address.

The Role of the Exchange Rate Policy

Given the external debt situation, the Philippines' best recourse is to pursue the export-led economic growth. Otherwise, growth would eventually be constrained by balance-of-payments difficulties. This places a central role on the exchange rate policy in industrial development, especially within the context of trade liberalization.

The exchange rate policy in the past has been one of the penalty, not protection, to the export sector.³ It is added to the penalty already received by exports from the protection system which defends an artificially cheaper foreign exchange. In the 1950s and 1960s, the maintenance of an undervalued foreign exchange was made possible by import controls and high tariffs, at least until BOP difficulties forced a devaluation. Beginning in the early 1970s, the exchange rate was supposedly allowed to float but it was still effectively managed by the Central Bank. Foreign borrowing, which started to grow in the 1970s, and to burgeon in the 1980s, propped up the peso, hiding an underlying BOP disequilibrium. When the 1983-84 BOP crisis erupted, the peso, again had to be devalued drastically. The Philippines, thus has a history of trying to maintain a fixed exchange rate until extreme BOP difficulties made it impossible to do so.

The most basic and general impact of an undervaluation of foreign exchange (or overvaluation of the peso) is to raise the price of Nontradables (NT) relative to that of Tradables (T), exportables (X) and importables (M) alike. This makes the NT sectors, in general, more

³It also penalized efficient but neglected import substitutes (those which received low effective protection).

attractive relative to the T sectors, inducing a corresponding flow of resources. This results from a strong domestic currency whether arising from an implicit BOP disequilibrium supported by overborrowing, or an overwhelming comparative advantage in a particular sector (e. g. export of labor).⁴

The impact within these two general sectors are, of course, non-uniform, varying with respect to several factors, mainly profitability and value-added coefficient. With respect to the first factor, for example, an overvaluation of the peso would tend to wipe out industries with marginal competitive advantage. This induces greater reliance, with respect to export earnings, on industries with considerable competitive advantage.⁵

With respect to the second factor, although an undervaluation of foreign exchange lowers the relative price of the export or the import substitute, the cheaper price of foreign exchange lowers, at the same time, the cost of imported inputs,⁶ mitigating somewhat the loss in profitability. Hence, in general, with everything else being equal, the lower the value-added ratio of the activity, the less negatively affected it is by the peso appreciation and the more able it could adjust.

⁴ In other words, the overabundant foreign borrowing (or other capital inflow such as portfolio investments) or earnings from labor exports make other foreign exchange earning and saving activities unattractive.

⁵ Or with respect to foreign exchange saving, on import substituting industries with considerable competitive advantage and/or high protection.

⁶ The same conclusion is arrived at for any traded input, whether actually imported, a domestic import substitute, or an exportable.

As a corollary to the above, a nontradable sector (whether a "true" nontradable with natural protection or a virtual nontradable due to prohibitive tariff or import control protection) with low value added benefits most from an overvaluation of the peso (or undervaluation of foreign exchange. In sum, ranging from sectors most favorably affected to sectors most adversely affected by an unrealistically low exchange rate, the nontradable sectors (including "virtual" nontradables due to prohibitive tariffs and/or import control) with low domestic value added would rank highest, benefitting most from a real peso appreciation, while exporting sectors with high domestic value added would rank lowest, losing most from peso appreciation. In between would be the nontradables with high domestic value added -- which are nonetheless still positively affected, and exporting and import-competing sectors with low domestic value added -- which are less adversely affected by the peso appreciation.

This pattern of incentives is an inherent impact of an exchange rate policy which tends to prop up the peso. Still, there seems to be great reluctance on the part of the government (particularly the Central Bank) to make the necessary exchange rate adjustment.

The Philippines tried to maintain a fixed nominal exchange rate for periods of time, until it was forced to devalue. With higher domestic inflation relative to the world, this meant a real appreciation of the peso. Table 2.19 presents the Real and Nominal Effective exchange rate⁷ indices from 1972 to 1994.

⁷The nominal effective exchange rate index is a trade weighted average of the peso -exchange rate index of major trading partners. The real effective exchange rate index adds to changes in the nominal effective exchange rate index the domestic inflation net of inflation rate of respective trading partners.

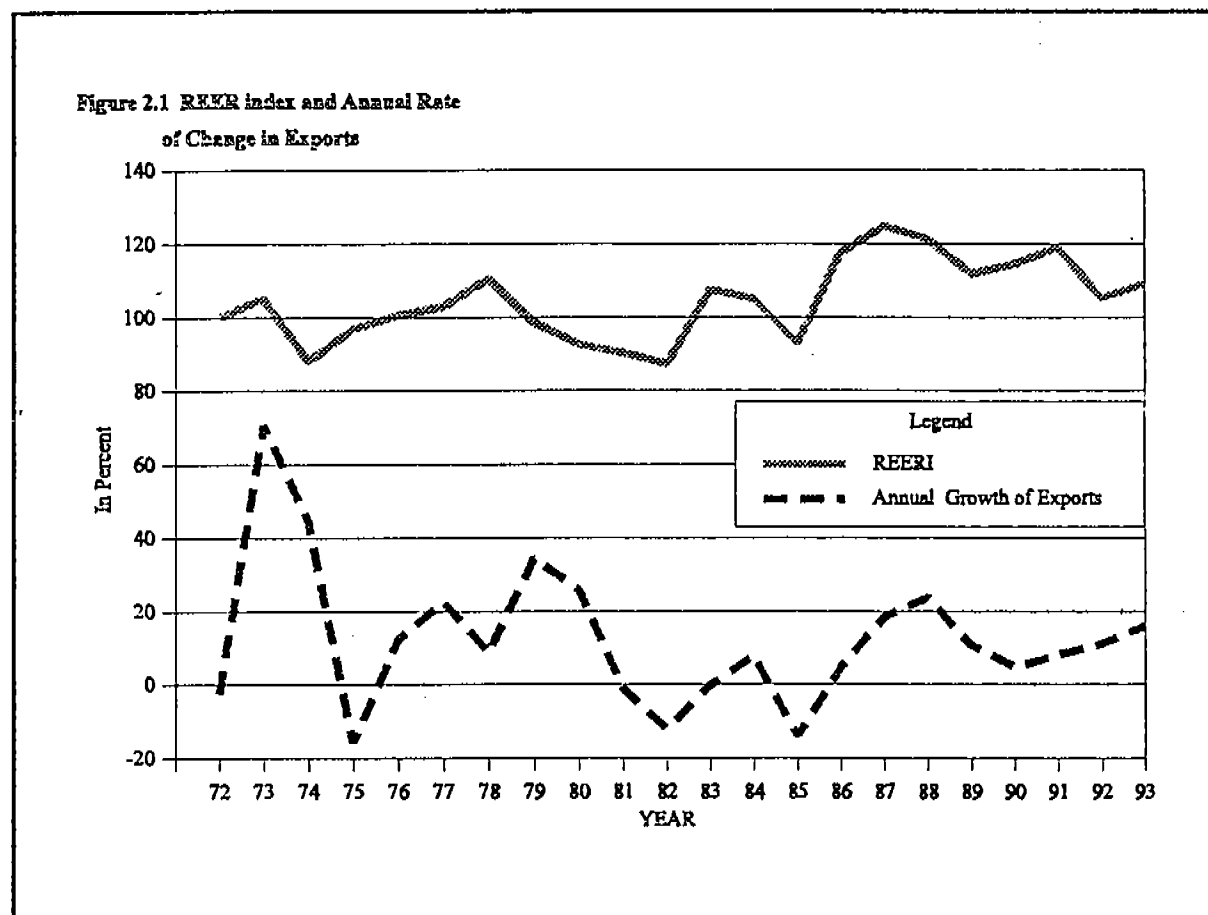
Table 2.19 shows the real effective exchange rate index (REERI) falling until 1982 , indicating a real appreciation of the peso. With the huge devaluation in 1983-84, it rose to an index above 100 but fell again in 1985 with inflation rates that reached as high as 50 percent. The REERI rose again from 1986 to 1988. The index, however, has been declining again in the 1990s.

Table 2.19 Nominal and real effective exchange rate index ,1972-1994 (1972=100)

YEAR	Nominal Effective Exchange Rate Index (%)	Real Effective Exchange Rate Index (%)
1972	100.00	100.00
1973	108.89	105.01
1974	107.61	87.88
1975	114.71	96.79
1976	115.78	100.43
1977	119.00	102.94
1978	130.01	110.60
1979	130.03	98.41
1980	131.52	92.51
1981	133.91	90.21
1982	136.18	87.30
1983	174.27	107.49
1984	254.57	105.04
1985	276.93	92.80
1986	348.12	117.64
1987	373.49	124.76
1988	406.36	121.27
1989	407.13	111.80
1990	456.36	114.47
1991	521.24	118.93
1992	498.18	105.23
1993	538.88	108.97
1994	536.60	100.19

Source : International Financial Statistics. International Monetary Fund (various years).
ADB Key Indicators. Asian Development Bank.

It is interesting to note how these changes in REERI affects exports. In Figure 2.1, the movement of the changes in REERI is plotted in the upper graph while the movement in the changes in exports is plotted in the lower graph. The graphs show an almost synchronized movement between REERI and exports.



Going back to Table 2.19, there seems to be a positive movement in the REERI from 1986-1988. This apparent depreciation of the peso, however, was brought about by worldcurrency realignment--with the US dollar, during the period, depreciating against the major world currencies. Being almost pegged to the US dollar, the peso depreciated along with it.

However, in 1989, especially the latter months, the US dollar is again gaining strength, and, indeed, there appears to be a downward trend in REERI in the 1990s.

The more revealing indicator of the competitiveness of the peso would, however, be how the peso fared with the currencies of our major competitors, specifically, Thailand, Taiwan, South Korea, Singapore and Hongkong. This is shown by the movement in the real exchange rate index between the peso and the currencies of these countries as presented in Table 2.20.

Table 2.20 shows the peso/won real exchange rate index rising in the 1983-84 but falling again in 1985-1986. Hence, the peso became relatively cheaper in 1983-84 only to lose some competitiveness again against the Korean won in 1985-1986. The index started to rise again after 1986 until 1988. The figures in the 1990s, again however seems to indicate a downward trend. The peso/HK\$ real exchange rate index has fallen from the 1973 index but at least has been maintained in the past three years. The peso/baht real exchange rate was falling from 1972 to 1982, but the index rose in 1983-84. Then it started falling again, continuously until the 1990s. Thailand appears to have used the exchange rate more aggressively. Taiwan, on the other hand, with its long-running BOP surplus, has been under pressure to revalue its currency. Thus, the peso/Taiwan dollar exchange rate index has risen substantially since 1973. The movement of the peso against the Singapore dollar is similar to that as the peso/won index.

The Philippine exchange rate policy has, thus, not changed much. After a series of de facto devaluations in 1983-84, it has moved closely with the US dollar. The Philippines has not used the exchange rate as aggressively as Thailand, for example. A more aggressive exchange

rate policy could have worked very well as a complementary measure to accompany import liberalization.

**Table 2.20 Nominal exchange rate and real exchange rate index:
Philippines vs. Korea, Singapore, Thailand, Taiwan & Hongkong
1972-1994**

YEAR	<u>Korea</u>		<u>Singapore</u>		<u>Thailand</u>	
	Nominal	Real (%)	Nominal	Real (%)	Nominal	Real (%)
1972	0.0169	100.00	2.3747	100.00	0.3207	100.00
1973	0.0170	89.48	2.7649	128.85	0.3277	103.61
1974	0.0167	80.22	2.7855	115.28	0.3332	95.89
1975	0.0150	85.66	3.0565	120.11	0.3557	99.45
1976	0.0154	95.84	3.0113	108.62	0.3647	100.22
1977	0.0153	97.30	3.0347	104.36	0.3629	99.21
1978	0.0152	103.39	3.2391	108.44	0.3622	99.41
1979	0.0152	102.81	3.3928	97.58	0.3613	90.27
1980	0.0124	94.67	3.5078	91.38	0.3668	93.05
1981	0.0116	96.32	3.7393	93.03	0.3621	91.48
1982	0.0117	94.34	3.9907	93.34	0.3713	89.29
1983	0.0143	109.04	5.2591	114.81	0.4832	110.57
1984	0.0207	105.39	7.8285	116.06	0.7064	106.89
1985	0.0214	87.23	8.4570	99.09	0.6851	81.58
1986	0.0231	95.49	9.3625	107.60	0.7752	93.17
1987	0.0232	95.75	9.7769	108.82	0.6922	81.95
1988	0.0289	113.43	10.4904	103.57	0.8342	91.08
1989	0.0324	119.39	11.1455	99.97	0.8457	86.14
1990	0.0343	120.02	13.4130	109.57	0.9502	89.69
1991	0.0375	119.64	15.9059	113.17	1.0769	89.99
1992	0.0327	101.11	15.6611	103.95	1.0044	79.64
1993	0.033	101.75	16.7843	105.88	1.0711	81.72
1994	0.0329	96.15	17.2954	102.84	1.0504	77.11

continuation...Table 2.20

YEAR	<u>Taiwan</u>		<u>Hongkong</u>	
	Nominal	Real (%)	Nominal	Real (%)
1972	0.1666	100.00	1.1881	100.00
1973	0.1766	100.03	1.3119	114.53
1974	0.1786	115.34	1.3370	94.81
1975	0.1907	119.64	1.4675	98.89
1976	0.1958	118.55	1.5172	99.69
1977	0.1948	116.83	1.5879	102.08
1978	0.1988	117.17	1.5722	99.44
1979	0.2047	109.99	1.4747	86.23
1980	0.2086	113.09	1.5094	85.86
1981	0.2144	119.83	1.4125	81.23
1982	0.2183	113.42	1.4065	81.17
1983	0.2774	134.29	1.5280	88.07
1984	0.4217	136.33	2.1360	85.93
1985	0.4669	119.34	2.3883	78.96
1986	0.5388	137.63	2.6126	88.01
1987	0.5399	156.02	2.6694	89.23
1988	0.7401	172.64	2.7020	87.21
1989	0.8232	178.59	2.7868	88.17
1990	0.9040	178.17	3.1212	94.86
1991	1.0248	175.12	3.5361	100.73
1992	1.0138	165.49	3.2957	94.30
1993	1.0130	157.57	3.5057	101.22
1994	1.0109	137.84	3.4183	81.56

Source : International Financial Statistics. International Monetary Fund (various years).
ADB Key Indicators. Asian Development Bank (various years).

In the 1990s, an extended trend of real (and sometimes, even nominal) peso appreciation again ensued, this time resulting from the liberalization of capital account within the context of stringent fiscal and monetary ceilings. While this has positive impact in the short run on inflation, it has adversely affected the competitiveness of Philippine exports. If prolonged, it

could have a longer run impact on resource allocation and eventually on overall industrial performance.

The Role of Monetary Policy

The preceding sections discussed the three major policy instruments which shape the overall industrialization policy -- trade policy, the investment incentives system, and the exchange rate regime. There are, of course, other important government policies affecting industrial performance, particularly monetary and fiscal policy. Some would even argue to the extent that improving the overall macroeconomic policy is the single most important policy reform to foster economic growth, including industrial performance.

This paper has focused on the three major policies, since they generally affect individual industries in a diverse manner, whereas the impact of the overall macroeconomic policy, unless specifically altered, is more or less non-discriminatory. Trade policy for example could favor the pulp and paper industry more than yarn production with higher tariffs for the former. The lower exchange rate would favor nontradables over tradables. Investments under the IPP are favored with fiscal incentives. The overall macroeconomic policy, however, would not generally differentiate between sectors, nor should it be designed to target specific sectors for promotion.

Nonetheless, monetary and fiscal reforms should be part of the whole package of policies for economic development. The impact of these reforms on interest rate and the supply of investments would directly affect industrial performance. Indeed macroeconomic stability which

promote savings and investment has been a basic ingredient in the success of the successful East Asian economies (World Bank, 1993).

What has caused difficulties in policy making especially during the past three years has been the monetary-fiscal-and-exchange-rate-policy nexus. As earlier noted, bound by stringent fiscal and monetary ceilings, the liberalization of capital account⁸ has led to an extended trend of peso appreciation. Removing the barrier to the exit of capital added much to the perceived security of foreign stockholders in keeping their money here and encouraged the inflow (rather than the outflow) of capital. This is manifested, for example, in the sharp rise in portfolio investments. Given the budget deficit and monetary ceiling, this contributed to the current appreciation of the peso. This has penalized exporters to a significant extent. Such impact on the exchange rate, however, has been unintended. And conflicting objectives seemed to prevent a more direct solution to the problem.

A more relevant concern for this paper is the use of policies which could directly discriminate between industrial sectors, affect the allocation of resources between them, and thus affect the overall industrial development. It is thus enough for the purposes of this paper to ensure that the overall macroeconomic policy would maximize the supply of investment funds and determine interest rates reflective of the real scarcity of capital. Furthermore, monetary and fiscal reforms and reforms for the development of the capital market are on-going, designed to

⁸The capital account liberalization is brought about largely by the foreign exchange liberalization. There are still government regulations concerning capital flows. However with the liberalization of the foreign exchange market, barriers to capital outflows became practically nil.

improve the overall macro economic policy environment in general, which would work as well for the industrial sector.

This section thus examine how monetary and fiscal policies have been used as special instruments for selective promotion of industries. The use of fiscal instruments, specifically, BOI fiscal incentives, represent the major element of the investment incentives system and has been discussed in an earlier section. This section now turns to the use of monetary instruments to promote certain activities. How effectively these instruments have been used for selective industrial promotion is the main thrust of this paper.

This would relate mainly to credit access. Easier access to credit for selected activities has been identified by various studies (World Bank, 1993) as among the most effective promotion tool. In particular, how well the export sector has been served seems to be critical.

The Philippines has had some experience in selective credit allocation for exports through the CB rediscounting window (Table 2.21). It comprises the most important export financing scheme for short term working capital in the Philippines, accounting for 80 percent of pre-shipment and 100 percent of post-shipment working capital export loan (Ali, 1988). The availability of export financing for working capital could prove to be crucial to the extent that even confirmed export orders may not be filled without it. The amount of CB rediscounting export loans, however, has not been enough nor very consistent.

The CB outstanding export loans to commercial banks peaked during the period 1980-1982 at around P6 billion, going down to P1.9 billion in 1992, with up and down movements in between. Moreover, although this accounts for around half of total CB outstanding loans to commercial banks, the amount is minimal compared to the total outstanding loans of commercial bank, at only around 1 percent in 1992. Furthermore, the amount represents only around 1 percent of commodity exports in 1992, indicating a very low export coverage. This also meant a very small number of exporters (around two to three hundred out of around four thousand) with access to the CB export loans (Ali 1988). In contrast, export financing in Thailand reached up to around 40 percent of export value. Clearly, some improvements to granting credit access to exporters are needed.

The problem of export financing is, of course, more complex than simply providing access. There are inherent institutional distortions involved in lending to exporters which are predominantly small. Moreover, there are additional difficulties with respect to reaching indirect exporters. Commercial banks have by and large been unable to service the financing needs of the export sector. Their conservative approach has been a major problem which the various guarantee schemes have been unable to remedy.

In sum, there is a need to improve export financing. This would entail increased efforts to improve risk pooling, e. g., by way of gathering and providing information on credit worthiness of exporters. More ways and means to supplement guarantee schemes with risk reducing activities like technical assistance should be sought. In general, a more detailed study

Table 2.21 Central Bank Rediscounting of Export Loans in the Philippines

	Ave. Exchange Rate	(a) Central Bank Export Loans Outstanding to Commercial Banks		(b) Total Central Bank Loans Outstanding to Commercial Banks		(c) Total Loans Outstanding of Commercial Banks		(d) Commodity Export			
Year	P/\$	(PM)	(US\$M)	(PM)	(US\$M)	(PM)	(US\$M)	(US\$M)	(a)(b)	(a)(c)	(a)(d)
1975	7.30	1,438	196.99	2,305	315.75	-	-	2,294	0.62	-	0.09
1980	7.57	6,318	834.61	9,321	1,231.31	77,198	10,197.89	5,788	0.68	0.08	0.14
1981	7.96	5,846	734.42	12,063	1,515.45	86,505	10,867.46	5,720	0.48	0.07	0.13
1982	8.60	6,122	711.86	13,296	1,546.05	98,240	11,423.26	5,021	0.46	0.06	0.14
1983	11.19	3,844	343.52	8,812	787.49	115,390	10,311.89	5,005	0.44	0.03	0.07
1984	16.85	2,092	124.15	4,835	286.94	120,355	7,142.73	5,391	0.43	0.02	0.02
1985	18.86	2,162	114.63	5,425	287.65	91,827	4,868.88	4,629	0.40	0.02	0.02
1986	20.40	1,174	57.55	3,487	170.93	88,325	4,329.66	4,843	0.34	0.01	0.01
1987	20.57	1,736	84.39	3,994	194.17	101,112	4,915.51	5,720	0.43	0.02	0.01
1988	21.07	1,999	94.87	3,678	174.56	126,615	6,009.25	7,074	0.54	0.02	0.01
1989	21.74	2,687	123.60	4,459	205.11	165,858	7,629.16	7,821	0.60	0.02	0.02
1990	24.38	4,594	188.43	6,814	279.49	199,645	8,188.88	8,186	0.67	0.02	0.02
1991	28.00	4,955	176.96	6,949	248.18	144,306	5,153.79	8,840	0.71	0.03	0.02
1992	25.92	1,905	73.50	3,115	120.18	236,117	9,109.45	9,824	0.61	0.01	0.01

Source: Lifted from Table 6.1 of "Catching Up with Asia's Tigers" by Medalla, Tecson, Bautista, Power & Associates, 1994

is needed to examine further the options and solutions available which would lead to a more automatic credit access for exporters.

Box 2.3

**REFORMS FOR ASSURING AUTOMATIC ACCESS
TO EXPORT FINANCING**

Reforms for assuring automatic access to export financing will involve modernization of the pre-shipment export financing system. Modernization of the export financing system is the first step in achieving equal and automatic access to pre-shipment export loans because it: (i) saves funds by eliminating waste and misuse; (ii) provides indirect exporters with access to export financing (taken up in Chapter XVII); (iii) reduces risk associated with lending to small exporters by using the input or output being financed by commercial handling banks as physical collateral; and (iv) institutes efficient and automatic administrative mechanisms.

Key elements in the modernization of the pre-shipment export financing system would include (i) disaggregating export loans; (ii) introducing automatic export loan disbursing mechanisms and automatic export loan pay-off mechanisms; (iii) creating quasi-physical collateral by using commodities financed by export loans; (iv) introducing a domestic letter of credit (L/C) system; (v) developing a plan to combine export loans based on actual export orders with loans based on expected mechanism with speed and administrative convenience.

The automatic loan disbursement mechanism prevents abuse. Disaggregation of export loans amounts to classifying them by type of expense and granting these loans at the time payment is made. By eliminating waste arising from granting a loan before it is actually needed, the automatic loan disbursement mechanism increases efficiency.

To assure equal access to export financing for small producers, the conservative lending practices of commercial banks will have to be altered. An alternative to physical collateral must be provided because of smaller exporters, who can play an important role in the country's export efforts, and those larger exporters who have already borrowed up to their collateral limits, may find that even with confirmed orders from buyers abroad, they are turned down for pre-shipment loans. To overcome the hesitation of commercial banks, an effective pre-shipment export finance guarantee scheme should be established. While the design of the scheme will be influenced by information gathering and dissemination, risk pooling and risk reducing activities, it should have certain characteristics: (i) pre-shipment guarantee should be optional, and not a mandatory requirement for receiving pre-shipment export loans; and (ii) underwriting risks needs to be shared between the guarantee agency and the

This box is lifted from Ifzal Ali, Sept. 1988, ADB.

The Resulting Philippine Trade Patterns and Production Structure

The Philippine trade structure has changed substantially in the last decade. Even as late as the mid 1960s, it was still basically an agriculture and mineral exporter. By the 1980s, manufactured exports comprised more than one third of total exports. By the 1990s, this share rose further to 79 percent. In 1970, more than 80 percent of Philippine exports were in the Food and Food preparations (0) and Crude material, inedible (2) category. This share consistently went down to only around 15 percent in 1993 (Tables 2.23 and 2.25).

Some of the changes can be attributed to external factors, e.g., prices of sugar, copper, etc. Still, an important part can perhaps also be a reflection of a conscious effort, starting in the 1970s, to promote nontraditional exports. The share of traditional exports has fallen sharply from 53 percent in 1980 to 11 percent in 1994. Much of the decline in share occurred in sugar products (from 11.35 percent in 1980 to 0.57 percent in 1994), mineral metallic products (from 15.9 percent to 3.2 percent), and coconut products (from 14.0 to 4.3 percent). On the other hand, the share of nontraditional manufactured exports doubled from 34.6 percent in 1980 to 81.0 percent in 1994. It is worth noting the rise in the share of processed food and beverage (from 1.59 to 2.48 percent) and furnitures and fixtures (from 1.33 to 1.78 percent). However, the increase in exports is still concentrated mainly in electronics and garments, products of low value-added and high import content (Tables 2.24 to 2.25). This indicates some weakness in the apparently healthy growth of nontraditional exports.

Table 2.22 Philippine imports/exports by 1-digit PSCC category
(in million US \$)

CODE	Imports (CIF)	1970	1980	1992	1993
0	Food & food preparations	125	572	1,115	1,268
1	Beverages & tobacco	9	52	133	136
2	Crude materials, inedible	21	322	680	776
3	Mineral, fuels & lubricants	144	2,358	2,159	2,162
4	Animal & vegetable oils & fats	6	20	37	26
5	Chemicals	141	811	1,618	1,813
6	Manufactured goods classified mainly by materials	271	1,070	2,331	2,814
7	Machinery & transport equipment	443	1,958	4,422	6,146
8	Misc. manufactures	34	211	454	623
9	Commodities & transactions, nec.	44	921	2,516	3,010
	TOTAL IMPORTS	1,286	8,295	15,464	18,773
CODE	Exports (FOB)	1970	1980	1992	1993
0	Food & food preparations	272	1,402	1,132	1,329
1	Beverages & tobacco	15	32	54	44
2	Crude materials, inedible	571	1,446	492	388
3	Mineral, fuels & lubricants	17	38	238	229
4	Animal & vegetable oils & fats	96	573	495	370
5	Chemicals	5	89	268	262
6	Manufactured goods classified mainly by materials	69	532	682	800
7	Machinery & transport equipment	1	127	1,646	2,119
8	Misc. manufactures	9	610	1,657	1,773
9	Commodities & transactions, nec.	1	903	3,061	4,061
	TOTAL EXPORTS	1,057	5,752	9,726	11,375

Source : Census of Manufacturing Establishment. National Statistics Office.

Table 2.23 Percentage distribution of Philippine imports/exports by 1-digit PSCC category, (in per cent)

CODE	Imports (CIF)	1970	1980	1992	1993
0	Food & food preparations	9.72	6.90	7.21	6.75
1	Beverages & tobacco	0.70	0.63	0.86	0.72
2	Crude materials, inedible	1.63	3.88	4.40	4.13
3	Mineral, fuels & lubricants	11.20	28.43	13.96	11.52
4	Animal & vegetable oils & fats	0.47	0.24	0.24	0.14
5	Chemicals	10.96	9.78	10.46	9.66
6	Manufactured goods classified mainly by materials	21.07	12.90	15.07	14.99
7	Machinery & transport equipment	34.45	23.60	28.60	32.74
8	Misc. manufactures	2.64	2.54	2.94	3.32
9	Commodities & transactions, nec.	3.42	11.10	16.27	16.03
	TOTAL IMPORTS	100.00	100.00	100.00	100.00
CODE	Exports (FOB)	1970	1980	1992	1993
0	Food & food preparations	25.73	24.37	11.64	11.68
1	Beverages & tobacco	1.42	0.56	0.56	0.39
2	Crude materials, inedible	54.02	25.14	5.06	3.41
3	Mineral, fuels & lubricants	1.61	0.66	2.45	2.01
4	Animal & vegetable oils & fats	9.08	9.96	5.09	3.25
5	Chemicals	0.47	1.55	2.76	2.30
6	Manufactured goods classified mainly by materials	6.53	9.25	7.01	7.03
7	Machinery & transport equipment	0.08	2.21	16.92	18.63
8	Misc. manufactures	0.85	10.61	17.04	15.59
9	Commodities & transactions, nec.	0.05	15.70	31.47	35.70
	TOTAL EXPORTS	100.00	100.00	100.00	100.00

Source : Census of Manufacturing Establishment (various years). National Statistics Office.

Table 2.24 Value of exports by major commodity group
(FOB value in Million US\$)

	1970	1980	1990	1994
Traditional Exports	984	3,068	1,437	1,505
Coconut prods.	209	811	496	607
Sugar and prods.	196	657	133	77
Forest prods.	278	425	94	26
Mineral prods.	217	918	361	436
Fruits and vegetables	32	111	162	184
Non-traditional Exports	72	2,650	6,635	11,723
Non-traditional manufactures	72	2,005	5,995	10,917
of which:				
Electrical Equipment	0	671	1,964	9,894
Garments	0	502	1,776	2,375
Textiles	6	74	93	173
Footwear	1	67	78	176
Wood Manufactures	11	35	117	129
Furnitures & fixtures	1	77	189	240
Processed food & beverages	8	92	207	335
TOTAL EXPORTS	1,062	5,788	8,186	13,483

Source : Census of Manufacturing Establishment (various years). National Statistics Office.

Such flow which could be discerned in the growth of nontraditional exports is manifested in the import structure as well. While the share in exports of electronics and garments grew, the share in imports of raw materials for garments and electronics correspondingly rose (Tables 2.26 and 2.27).

Imports share of mineral fuels and lubricants increased as expected before declining starting 1986 when oil prices went down. The share in imports of food, beverage and tobacco remained stable in the 1970s to 1980s. Imports share of machinery and equipment declined, from 34 percent in 1970 to only 17 percent in 1987, as the economy plunged into a deep recession in 1984 and 1985, before again rising to 34 percent in 1994. With trade liberalization

especially beginning in the latter half of the 1980s, however, the share of consumer products in total imports have risen substantially.

Table 2.25 Percentage distribution of exports by major commodity group

	1970	1980	1990	1994
Traditional Exports	92.66	53.01	17.55	11.16
Coconut prods.	19.68	14.01	6.06	4.50
Sugar and prods.	18.46	11.35	1.62	0.57
Forest prods.	26.18	7.34	1.15	0.19
Mineral prods.	20.43	15.86	4.41	3.23
Fruits and vegetables	3.01	1.92	1.98	1.36
Non-traditional Exports	6.78	45.78	81.05	85.95
Non-traditional manufactures	6.78	34.64	73.23	80.97
of which:				
Electrical Equipment	0.00	11.59	23.99	36.97
Garments	0.00	8.67	21.70	17.61
Textiles	0.56	1.28	1.14	1.28
Footwear	0.09	1.16	0.95	1.31
Wood Manufactures	1.04	0.60	1.43	0.96
Furnitures & fixtures	0.09	1.33	2.31	1.78
Processed food & beverages	0.75	1.59	2.53	2.48
TOTAL EXPORTS	100.00	100.00	100.00	100.00

Source : Census of Manufacturing Establishment (various years). National Statistics Office.

Table 2.26 Philippine imports by selected commodity groups
(In Million US\$)

CODE	ITEM	1970	1980	1987	1994
0	FOOD & LIVE ANIMALS	125	572	513	1506
02	Dairy prods.	37	123	162	333
03	Fish & preparation	18	29	21	60
041	Wheat	36	180	94	324
1	BEVERAGES & TOBACCO	9	52	112	237
2	CRUDE MAT'L'S., INEDIBLE	69	322	325	977
3	MINERAL OILS & LUBRICANTS	144	2,368	1,307	2,161
4	ANIMAL OILS & FATS	6	20	15	41
5	CHEM'L'S & REL. PRODS.	141	811	1,009	2,191
51-52	Chemical compounds	43	292	366	575
54	Pharmaceuticals	19	72	108	269
6	MFD. GOODS CLASSIFIED BY MAT'L.	271	1,070	1,030	3,141
64	Paper & paper prods.	35	81	117	297
65	Textile, yarns & fabrics	29	151	288	822
67	Iron & steel	121	429	372	970
7	MACHINERY & TRANSPORT EQPT.	443	1,968	1,193	7,585
71-75	Non-electrical mach'y.	265	1,070	571	2,974
76-77	Electrical mach'y.	74	328	463	2,701
78-79	Transport Equipment	104	560	159	1,910
8	MISC. MANUFACTURED ARTICLES	34	211	153	776
9	COMMODITIES, NEC.	44	921	1,531	4,022
	Mat'ls for mfr. of electronics	0	566	689	1,916
	Mat'ls. for mfr. of garments	23	90	155	411
	TOTAL IMPORTS	1,286	8,295	7,188	22,638

Source : Census of Manufacturing Establishment (various years). National Statistics Office.

Table 2.27 Percentage distribution of Philippine imports by selected commodity groups
(in per cent)

CODE	ITEM	1970	1980	1987	1994
0	FOOD & LIVE ANIMALS	9.72	6.90	7.14	6.65
02	Dairy prods.	2.88	1.48	2.25	1.47
03	Fish & preparation	1.40	0.35	0.29	0.27
041	Wheat	2.80	2.17	2.19	1.43
1	BEVERAGES & TOBACCO	0.70	0.63	1.56	1.05
2	CRUDE MAT'L'S., INEDIBLE	5.37	3.88	4.52	4.32
3	MINERAL OILS & LUBRICANTS	11.20	28.55	18.18	9.55
4	ANIMAL OILS & FATS	0.47	0.24	0.21	0.18
5	CHEM'L'S & REL. PRODS.	10.96	9.78	14.04	9.68
51-52	Chemical compounds	3.34	3.52	5.09	2.54
54	Pharmaceuticals	1.48	0.87	1.50	1.19
6	MFD.GOODS CLASSIFIED BY MAT'L.	21.07	12.90	14.33	13.87
64	Paper & paper prods.	2.72	0.98	1.63	1.31
65	Textile, yarns & fabrics	2.26	1.82	4.01	3.63
67	Iron & steel	9.41	5.17	5.18	4.28
7	MACHINERY & TRANSPORT EQPT.	34.45	23.73	16.60	33.51
71-75	Non-electrical mach'y.	20.61	12.90	7.94	13.14
76-77	Electrical mach'y.	5.75	3.95	6.44	11.93
78-79	Transport Equipment	8.09	6.75	2.21	8.44
8	MISC. MANUFACTURED ARTICLES	2.64	2.54	2.13	3.43
9	COMMODITIES, NEC.	3.42	11.10	21.30	17.77
	Mat'ls for mfr. of electronics	0.00	6.82	2.16	1.91
	Mat'ls. for mfr. of garments	2.81	1.08	9.56	8.46
	TOTAL IMPORTS	100.00	100.00	100.00	100.00

Source : Census of Manufacturing Establishment, National Statistics Office.

There is some change in the direction of trade as well. The US share in Philippine exports has fallen from an average of more than 43 percent in the 1960s. Still, it has maintained its share of around one third as destination of Philippine exports and around a quarter as a source of Philippine imports during the 1980s (Table 2.28). In contrast, the share of Japan in Philippine trade has gone down from around 28 percent in the 1970s to 18 percent in 1990s of total Philippine exports. Meanwhile, the share in Philippine trade has grown for ASEAN, Hongkong, South Korea and Australia. In particular, there appears to be a trend towards larger trade with developing countries. Table 2.29 presents the Philippine exports and imports to and from the U.S. and other countries.

Despite some success in diversification, both in products as well as markets, on the whole, the Philippine merchandise trade balance remained negative, except for a few years, in the last two decades. Imports and exports peaked in 1980/81 then declined in the succeeding years until 1986. Merchandise exports fell from U.S. \$5.788 B in 1980 to U.S. 4.629 B in 1985 due mainly to a fall in primary commodity prices (particularly coconut, sugar and copper). As a result, the share of exports in GNP went down sharply from 53 percent in 1980 to 24 percent in 1984. Exports started to pick up in 1986, growing by almost 25 percent in the first half of 1988. In the 1990s, exports continued to grow at around 12 percent. Imports declined even more sharply from U.S. \$7.946 B (f.o.b.) in 1981 to U.S. \$5.044 B (f.o.b.) in 1986 following the economic recession during the period. It has risen since then, with economic recovery, contributing to a worsening trade deficits in the 1990s.

Table 2.28 Merchandise Trade, 1965-1993, in million US\$

YEAR	WORLD		Annual Growth Rate		UNITED STATES		Annual Growth Rate		JAPAN		Annual Growth Rate	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1965	808	768			274	349			195	218		
1966	853	828	5.60	7.78	285	346	3.79	-0.69	244	264	24.78	21.46
1967	1,062	821	24.56	-0.81	363	353	27.48	1.81	307	279	25.84	5.43
1968	1,150	858	8.29	4.41	372	391	2.62	11.02	327	283	6.41	1.69
1969	1,131	855	-1.63	-0.36	320	360	-13.95	-7.95	337	329	3.09	16.05
1970	1,090	1,062	-3.66	24.23	315	440	-1.61	22.16	345	421	2.42	27.96
1971	1,186	1,136	8.79	7.04	291	459	-7.58	4.38	359	399	4.12	-5.27
1972	1,230	1,106	3.68	-2.72	313	447	7.36	-2.81	391	373	8.82	-6.30
1973	1,597	1,886	29.85	70.62	449	676	43.78	51.37	519	675	32.69	80.62
1974	3,143	2,725	96.87	44.46	734	1,157	63.40	71.13	865	949	66.74	40.72
1975	3,459	2,294	10.05	-15.80	754	664	2.69	-42.57	966	865	11.76	-8.87
1976	3,633	2,574	5.04	12.17	802	924	6.30	39.15	976	621	1.05	-28.16
1977	3,915	3,151	7.74	22.43	799	1,112	-0.33	20.30	975	727	-0.11	16.96
1978	4,732	3,425	20.88	8.70	996	1,156	24.58	3.97	1,285	818	31.77	12.59
1979	6,342	4,601	34.01	34.35	1,402	1,384	40.87	19.71	1,398	1,201	8.78	46.75
1980	7,727	5,788	21.84	25.79	1,786	1,588	27.33	14.75	1,531	2,533	9.53	110.93
1981	7,946	5,722	2.83	-1.13	1,757	1,766	-1.59	11.17	1,494	1,250	-2.42	-50.64
1982	7,667	5,021	-3.51	-12.26	1,703	1,586	-3.10	-10.17	1,532	1,146	2.54	-8.40
1983	7,487	5,005	-2.35	-0.30	1,739	1,800	2.14	13.44	1,266	1,015	-17.36	-11.39
1984	6,097	5,391	-18.57	7.70	1,631	2,051	-6.24	13.95	815	1,043	-35.66	2.73
1985	5,111	4,629	-16.17	-14.13	1,282	1,653	-21.37	-19.36	735	875	-9.83	-16.12
1986	5,044	4,842	-1.31	4.60	1,256	1,717	-2.04	3.83	868	851	18.20	-2.69
1987	6,737	5,720	33.57	18.14	1,485	1,976	18.26	15.11	1,121	981	29.14	15.32
1988	8,159	7,074	21.11	23.67	1,715	2,516	15.47	27.31	1,421	1,424	26.77	45.11

continuation... Table 2.28

YEAR	WORLD		Annual Growth Rate		UNITED STATES		Annual Growth Rate		JAPAN		Annual Growth Rate	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1989	10,419	7,821	27.69	10.55	1,979	2,946	15.40	17.08	2,043	1,591	43.76	11.72
1990	12,206	8,186	17.15	4.67	2,366	3,095	19.52	5.06	2,259	1,622	10.54	1.94
1991	12,051	8,840	-1.27	7.98	2,426	3,144	2.57	1.59	2,373	1,771	5.06	9.21
1992	14,519	9,824	20.48	11.14	2,620	3,832	7.99	21.88	3,087	1,745	30.09	-1.46
1993	17,597	11,375	21.20	15.78	3,522	4,371	34.43	14.08	4,037	1,827	30.77	4.68
Average Growth Rate												
1965-70	6.63	7.05			3.66	5.27			12.51	14.52		
1971-75	29.85	20.72			21.93	16.30			24.83	20.18		
1976-80	17.90	20.69			19.75	19.58			10.20	31.82		
1981-85	-7.55	-4.03			-6.03	1.81			-12.55	-16.76		
1986-90	19.64	12.33			13.32	13.68			25.68	14.28		
1991-93	13.47	11.64			15.00	12.52			21.97	4.14		
Average % Share												
1965-70	100.00	100.00			31.84	43.23			28.58	34.21		
1971-75	100.00	100.00			24.66	37.61			30.00	35.43		
1976-80	100.00	100.00			21.75	32.50			24.16	28.20		
1981-85	100.00	100.00			23.88	34.43			16.69	20.64		
1986-90	100.00	100.00			21.27	36.21			17.88	19.01		
1991-93	100.00	100.00			19.40	37.66			21.30	17.96		

Source : Foreign Trade Statistics (NSO)

Table 2.29 Philippine trade with regional bloc/country, 1989-1993 (in million US \$)

Regional Bloc/Country	Exports Value	% Share	Imports Value	% Share	Balance of Trade
TOTAL					
1993	11,375	100.00	17,597	100.00	-6,23
1992	9,824	100.00	14,519	100.00	-4,695
1991	8,840	100.00	12,051	100.00	-3,212
1990	8,186	100.00	12,206	100.00	-4,020
1989	7,821	100.00	10,419	100.00	-2,598
A. USA					
1993	4,371	38.43	3,522	20.02	849
1992	3,832	39.00	2,620	18.05	1,211
1991	3,144	35.56	2,426	20.13	717
1990	3,095	37.80	2,366	19.38	729
1989	2,946	37.66	1,979	19.00	966
B. Japan					
1993	1,827	16.06	4,037	22.94	-2,210
1992	1,745	17.77	3,087	21.26	-1,341
1991	1,771	20.04	2,373	19.69	-602
1990	1,622	19.81	2,259	18.50	-637
1989	1,591	20.35	2,043	19.61	-452
C.EC					
1993	1,973	17.33	1,782	10.13	189
1992	1,859	18.92	1,702	11.72	157
1991	1,642	18.57	1,248	10.35	394
1990	1,449	17.70	1,365	11.18	84
1989	1,326	16.96	1,172	11.25	154
D. Australia					
1993	114	1.01	473	2.69	-358
1992	113	1.15	407	2.80	-294
1991	104	1.18	380	3.15	-276
1990	96	1.18	369	3.03	-273
1989	124	1.59	347	3.33	-223
E. New Zealand					
1993	14	0.12	122	0.69	-108
1992	13	0.13	93	0.64	-81
1991	10	0.11	69	0.57	-59
1990	9	0.11	88	0.72	-79
1989	14	0.17	94	0.90	-81
F. Hongkong					
1993	548	4.82	877	4.98	-329
1992	464	4.72	721	4.96	-257
1991	392	4.43	596	4.95	-204
1990	330	4.04	555	4.54	-224
1989	305	3.90	481	4.62	-176

continuation... Table 2.19

Regional Bloc/Country	Exports Value	% Share	Imports Value	% Share	Balance of Trade
G.Korea, Republic of					
1993	221	1.94	898	5.10	-677
1992	176	1.79	697	4.80	-521
1991	228	2.58	609	5.05	-381
1990	230	2.80	478	3.92	-248
1989	175	2.24	423	4.06	-248
H. Taiwan					
1993	346	3.04	1,025	5.83	-679
1992	287	2.92	960	6.61	-673
1991	210	2.37	825	6.84	-615
1990	209	2.56	806	6.60	-596
1989	210	2.69	702	6.74	-492
I. Other ASEAN Countries					
1. Thailand					
1993	169	1.48	171	0.97	-2
1992	98	1.00	138	0.95	-40
1991	221	2.50	94	0.78	127
1990	156	1.91	137	1.12	19
1989	155	1.98	82	0.79	73
2. Indonesia					
1993	48	0.42	341	1.94	-293
1992	40	0.41	181	1.25	-141
1991	42	0.47	162	1.35	-120
1990	61	0.74	182	1.49	-121
1989	56	0.72	158	1.51	-102
3. Malaysia					
1993	161	1.42	356	2.02	-195
1992	128	1.30	387	2.67	-259
1991	123	1.39	298	2.47	-175
1990	127	1.55	272	2.23	-146
1989	99	1.27	266	2.56	-167
4. Singapore					
1993	380	3.34	978	5.56	-599
1992	252	2.57	551	3.79	-299
1991	229	2.60	455	3.78	-226
1990	240	2.93	487	3.99	-247
1989	221	2.83	493	4.73	-272
5. Brunei					
1993	2	0.02	51	0.29	-48
1992	2	0.02	92	0.63	-90
1991	1	0.01	95	0.79	-94
1990	1	0.01	110	0.90	-109
1989	1	0.01	47	0.46	-47

Source : Foreign Trade Statistics (various years). National Statistics Office.

The tables presented also show the bilateral trade between the U.S. and the Philippines and Japan and the Philippines. For the large part, Philippine trade with the United States has been growing steadily and has been affected less severely by the 1983-84 economic crisis. Imports from the United States grew from only U.S. \$ 274 M in 1965 to U.S. \$ 1,485 M (f.o.b.) in 1987, to U.S. \$ 3,522 M in 1993. Exports to the United States grew from U.S. \$349 M to U.S. \$ 1, 976 M to U.S. \$4,371 M during the same period. Also, for the most part during the period, the Philippines has been enjoying trade surpluses with the United States. The United States remains to be the Philippines' most important trading partner.

Table 2.30 Value of exports by major commodity group to USA
(FOB value in Million US\$)

	1980	1985	1990	1994
Traditional Exports	672	416	345	315
Coconut prods.	266	229	131	135
Sugar and prods.	171	78	62	43
Forest prods.	84	31	2	1
Mineral prods.	52	2	2	1
Fruits and vegetables	71	65	133	122
Non-traditional Exports	997	1,186	4,026	4,829
Non-traditional manufactures	870	1,102	3,915	4,678
of which:				
Electrical Equipment	292	369	1,534	1,962
Garments	245	444	1,292	1,408
Textiles	20	117	22	30
Footwear	38	9	64	81
Wood Manufactures	7	11	13	16
Furnitures & fixtures	41	53	104	135
Machinery & transport eqpt.	7	14	226	318
Processed food & beverages	74	51	50	56
TOTAL EXPORTS	1,679	1,615	4,371	5,143

Source : Census of Manufacturing Establishments. National Statistics Office.

Table 2.31 Percentage distribution of exports to the USA by major commodity group
(In per cent)

	1980	1985	1990	1994
Traditional Exports	40.02	25.76	7.89	6.12
Coconut prods.	15.84	14.18	3.00	2.62
Sugar and prods.	10.18	4.83	1.42	0.84
Forest prods.	5.00	1.92	0.05	0.02
Mineral prods.	3.10	0.12	0.05	0.02
Fruits and vegetables	4.23	4.02	3.04	2.37
Non-traditional Exports	59.38	73.44	92.11	93.89
Non-traditional manufactures	51.82	68.24	89.57	90.96
of which:				
Electrical Equipment	17.39	22.85	35.09	38.15
Garments	14.59	27.49	29.56	27.38
Textiles	1.19	7.24	0.50	0.58
Footwear	2.26	0.56	1.46	1.57
Wood Manufactures	0.42	0.68	0.30	0.31
Furnitures & fixtures	2.44	3.28	2.38	2.62
Machinery & transport eqpt.	0.42	0.87	5.17	6.18
Processed food & beverages	4.41	3.16	1.14	1.09
TOTAL EXPORTS	100.00	100.00	100.00	100.00

Source : Census of Manufacturing Establishments. National Statistics Office(Various years).

The trend in the Philippine bilateral trade with the United States followed in general the overall trend of Philippine trade with the world. There is also a significant shift away from nontraditional exports (Tables 2.30-2.33)

Among traditional exports, sugar and mineral products registered a sharp decline while the export share of fruits and vegetables (canned juice and concentrates) has more or less

remained unchanged. Coconut products remained important although their share dropped from around 15.8 percent in 1980 to 2.62 percent in 1994.

The share of nontraditional Philippine exports to the United States accounted for almost 94 percent in 1994, up from an already considerable share of 59 percent in 1980. Garments and electronics accounted for the largest share at around 27 percent and 38 percent respectively of total Philippine exports to the United States in 1994 (compared with 14.6 and 17.4 percent, respectively, in 1980). Aside from garments and electronics, fruit preserves and fruit preparations, as well as fresh/dried fruits and nuts have become consistent exports and exhibit a potential for more growth. Other promising exports include coffee and coffee substitutes, and furnitures and fixtures. In contrast with garments and electronics, these products have high value-added. There is a proliferation of other exports to the U.S. especially in the area of food manufactures.

On the imports side, machinery and transport equipment accounted for the largest share of imports from the United States at almost 40 percent in 1970, declining to less than 14 percent in 1987 before rising again to 34 percent in 1994. On the other hand, imports of raw materials for electronics and garments rose sharply from only U.S. \$26 M in 1970 to U.S. \$417 M, which is more than one third of total imports from the United States, in 1987. Food imports, particularly wheat, are also important, accounting for around 13 percent in 1970, down to around 8 percent in 1987 to 11 percent in 1994.

Table 2.32 Philippine imports from USA by selected commodity groups
(In Million US\$)

CODE	ITEM	1970	1980	1987	1994
0	FOOD & LIVE ANIMALS	50	247	127	450
02	Dairy prods.	6	4	8	6
03	Fish & preparation	.06031	0.2237	2	3
041	Wheat	33	174	72	301
1	BEVERAGES & TOBACCO	8	34	53	21
2	CRUDE MAT'L.S., INEDIBLE	32	103	148	187
3	MINERAL OILS & LUBRICANTS	0.0246	14	101	51
4	ANIMAL OILS & FATS	2	17	5	4
5	CHEM'LS & REL. PRODS.	43	121	201	287
51-52	Chemical compounds	12	73	68	90
54	Pharmaceuticals	7	13	14	21
6	MFD.GOODS CLASSIFIED BY MAT'L.	62	161	114	261
64	Paper & paper prods.	16	39	55	90
65	Textile, yarns & fabrics	7	13	9	21
67	Iron & steel	11	17	12	16
7	MACHINERY & TRANSPORT EQPT.	157	686	220	1,331
71-75	Non-electrical mach'y.	86	427	147	484
76-77	Electrical mach'y.	31	108	58	735
78-79	Transport Equipment	39	149	15	112
8	MISC. MANUFACTURED ARTICLES	14	68	46	146
9	COMMODITIES, NEC.	26	461	609	1,202
	Mat'ls for mfr. of electronics	0	370	417	62
	Mat'ls. for mfr. of garments	11	15	70	989
	TOTAL IMPORTS	392	1,908	1,623	3,941

Source : Census of Manufacturing Establishments. National Statistics Office(various years).

While substantial changes could be found in the Philippine trade structure, the gross structure of production changed very little during the past three decades. As table 2.34 indicates, the share of agriculture in total output varied little within the range of 25 to 30 percent from the 1960s to the 1980s. It was only in the 1990s when its share has gone down to 22 percent. Furthermore, the share of industry particularly manufacturing was almost stable - at around 32 percent for industry (includes construction and mining) and 24 percent for manufacturing. In contrast, the services sector has been registering a steady increase in share since 1975. By 1994, it accounts for the largest share at around 46 percent of total output.

More substantial changes could be noted for the sectoral share of employment but this is between agriculture and services. The share of agriculture has gone down from 61 percent in 1960 to 43 percent in 1994. But this was mostly taken up by the services sector whose share in employment rose from 26 percent to around 46 percent for the same period.

This seems to indicate a relatively stagnant industrial base. This is not really surprising given more than three decades of inward looking protectionist policies before reforms were undertaken beginning the latter half of the 1980s. The gross figures could perhaps not indicate as yet the changes in the industrial structure which are sure to follow the reforms.

**Table 2.33 Percentage distribution of Philippine imports from the USA
by selected commodity groups (In per cent)**

CODE	ITEM	1970	1980	1987	1994
0	FOOD & LIVE ANIMALS	12.76	12.95	7.83	11.42
02	Dairy prods.	1.53	0.21	0.49	0.15
03	Fish & preparation	0.15	0.01	0.12	0.08
041	Wheat	8.42	9.12	4.44	7.87
1	BEVERAGES & TOBACCO	2.04	1.78	3.27	0.53
2	CRUDE MAT'L.S., INEDIBLE	8.16	5.40	9.12	4.74
3	MINERAL OILS & LUBRICANTS	0.01	0.73	6.22	1.29
4	ANIMAL OILS & FATS	0.51	0.89	0.31	0.10
5	CHEM'LS & REL. PRODS.	10.97	6.34	12.38	7.28
51-52	Chemical compounds	3.06	3.83	4.19	2.28
54	Pharmaceuticals	1.79	0.68	0.86	0.53
6	MFD.GOODS CLASSIFIED BY MAT'L.	15.82	8.44	7.02	6.62
64	Paper & paper prods.	4.08	2.04	3.39	2.28
65	Textile, yarns & fabrics	1.79	0.68	0.55	0.53
67	Iron & steel	2.81	0.89	0.74	0.41
7	MACHINERY & TRANSPORT EQPT.	40.05	35.95	13.56	33.77
71-75	Non-electrical mach'y.	21.94	22.38	9.06	12.28
76-77	Electrical mach'y.	7.91	5.66	3.57	18.65
78-79	Transport Equipment	9.95	7.81	0.92	2.84
8	MISC. MANUFACTURED ARTICLES	3.57	3.56	2.83	3.70
9	COMMODITIES, NEC.	6.63	24.16	37.52	30.50
	Mat'ls for mfr. of electronics	0.00	19.39	25.69	25.10
	Mat'ls. for mfr. of garments	2.81	0.79	4.31	1.57
	TOTAL IMPORTS	100.00	100.00	100.00	100.00

Source : Census of Manufacturing Establishments. National Statistics Office (various years).

Table 2.34 Sectoral employment and output shares (In per cent)

SECTOR	1960		1965		1970		1975	
	Empl.	Output	Empl.	Output	Empl.	Output	Empl.	Output
Agriculture	61.2	26.5	56.7	27.2	53.7	29.5	53.5	30.3
Industry	12.6	31.3	11.3	31.1	12.6	31.9	12.1	35.0
Manufacturing	12.1	24.5	10.9	23.6	11.9	24.9	11.4	25.7
Services	26.2	42.2	31.5	41.7	32.1	38.6	34.1	34.7

SECTOR	1980		1985		1990		1994	
	Empl.	Output	Empl.	Output	Empl.	Output	Empl.	Output
Agriculture	51.4	25.2	49.0	24.6	45.2	22.1	43.1	22.0
Industry	11.6	38.8	10.7	35.0	10.7	35.1	11.3	32.5
Manufacturing	10.6	25.7	9.7	25.1	9.7	25.4	10.4	23.2
Services	36.5	36.1	40.2	40.3	44.1	42.8	45.6	45.5

To provide some indications about what is happening within the manufacturing sector, Tables 2.35 gives the share in value added of 2- digit PSIC (Philippine Standard Industrial Classification) manufacturing sectors. The table indicates that there are indeed some changes occurring within the sector. The share of Food in value added has significantly gone down from around 27 percent in 1972 to only around 17 percent in 1992. Furthermore, the share of electrical machinery has more than tripled for the same period, from less than 3 percent in 1972 to more than 9 percent in 1992. The share of chemicals have also grown significantly.

These findings, along with the DIA findings of increased competitiveness of Philippine industries accompanying reforms, provide some optimism for the Philippines in the future.

Table 2.35 Percentage distribution of census value added by 2-Digit PSIC

PSIC	Description	1972	1975	1978	1983	1988	1992
31	Manufacture of Food, Beverages and Tobacco	38.14	42.82	29.56	29.84	37.27	31.36
32	Textile, Wearing Apparel and Leather Industries	8.82	7.80	10.47	9.24	10.69	9.93
33	Manufacture of Wood and Wood Products, Including Furniture and Fixtures	8.07	3.73	3.30	4.76	4.06	2.12
34	Manufacture of Paper and Paper Products; Printing and Publishing	5.36	3.14	6.99	3.88	3.95	3.84
35	Manufacture of Chemicals and Chemical, Petroleum, Coal,	19.30	24.95	20.40	28.16	23.44	26.64
36	Rubber and Plastic Products	5.28	3.53	3.01	3.41	3.84	4.53
37	Manufacture of Non-Metallic Mineral Products, Except						
37	Products of Petroleum & Coal	2.49	3.08	1.22	8.36	6.09	4.49
38	Basic Metal Industries	12.77	11.04	20.57	11.80	9.93	16.10
39	Manufacture of Fabricated Metal Products, Machinery and Equipment						
39	Other Manufacturing Industries	0.00	0.00	0.72	0.55	0.96	0.99

Source : Census of Manufacturing Establishments. National Statistics Office (various years).

For 1992, data used were from Annual Survey of Establishments. National Statistics Office.

Chapter 3

The Effects of Philippine Trade and Investment Policies on the Performance of Manufacturing Companies : A Case Study

As discussed in the preceding chapter, the Philippines has undergone several trade and investment policy regimes in its pursuit for industrialization. This chapter investigates how a few selected manufacturing companies have responded to the changes in the country's trade and investment policies. More specifically, the study was conducted to determine (1) the effects of trade and investment policies of the country on the performance of companies; (2) how companies have responded to the changes in such policies; (3) the strategies companies have taken or will take to strengthen their competitiveness in response to a more open world trading system; and (4) other policy reforms that will enable companies to cope with the changes in the global trade environment.

While the goal was to cover 10 companies, only seven successfully responded to the survey. These companies were selected from among the 1994 top 2000 corporations of the country using the following criteria: (1) an exporting company; (2) a company with branch overseas; and (3) a promising company. A company must meet one or two of the criteria. Since the sample size of the survey is too small to make general conclusions, the findings of the survey are treated only as a case study.

The next section presents a brief profile of the respondent companies. This is followed by a discussion of development strategies adopted by the companies in terms markets and in strengthening their competitiveness in the light of the changes in the international trade environment. The effects of trade and investment policies on the performance of the companies are then analyzed. The final section discusses the future prospects of the companies with the emergence of regional trading blocs and the needed government policy reforms to enable them to survive under such an environment.

Profile of the Respondent Companies

The seven companies belong to the handbags and leather products industry (1), garment industry (1), automobile industry (1), electrical appliances (2), electrical and electronic components and assemblies industry (1), and ceramics industry (1). One of the companies started operations before 1970, 2 in the 1970s, 3 in the 1980s, and another 1 after 1990 (Table 3.1).

Table 3.1 Year of establishment

Period	Number of Companies
Before 1970	1
1970-79	2
1980-89	3
1990 up	1
Total	7

Business form of establishment. Upon establishment, only 1 company was a single proprietorship business while the rest were corporations, 5 of which were joint ventures (Table 3.2). At present, however, all are corporations with 6 as joint ventures with either Japanese, Korean, Taiwanese and Indian investors (Table 3.3). Only one of the companies is 100 percent Filipino-owned.

Table 3.2 Business form of establishment

Form of Establishment	Upon Establishment	At Present
Single Proprietorship	1	0
Corporation	6	7
Joint-venture	5	6
Subsidiary	0	0
Others	1	1
Total	7	7

Table 3.3 Stockholders

Nationality	Number of Firms
Filipino	1
Filipino-Chinese-Taiwanese	1
Filipino-Japanese	3
Filipino-Korean	1
Filipino-Indian	1
Total	7

Capitalization. Upon establishment, 3 of them were micro-scale industries with only less than P2 million capitalization; 1 was small scale, 1 medium scale and 2 were large scale having more than P15 million capitalization (Table 3.4). These companies have grown in capital size; 5 of them are now classified as large scale and only 2 are medium scale.

Table 3.4 Firm size

Type	Upon Establishment	At Present
1. By Capitalization		
Micro-scale (<P2m)	3	0
Small-scale (P2-4m)	1	0
Medium-scale (P4-15m)	1	2
Large-scale (P>15m)	2	5
Total	7	7
2. By Employment		
50 and below	2	0
51-100	1	0
101-200	3	2
201-350	1	0
351-500	0	0
501-1000	0	1
>1000	0	4
Total	7	7

Employment. In terms of employment, these companies have generated small employment at the start of their operation, the largest employment being between 201-350 workers (Table 3.4). At present, however, majority of these companies employ at least 1,000 workers, the highest being 6,000. This excludes, however, the employment generated by the companies' sub-contracting activities. Furthermore, most of the companies have a 100 percent Filipino workforce while only 2 companies also employ non-Filipinos although this comprises only less than 10 percent of their total workforce (Table 3.5).

Not only did these companies grow in capitalization but also the employment they generated went up. Employment for two of the companies posted an average annual growth rate of 56 percent (Table 3.6). It appears that employment growth was relatively high among the companies that started operations in the late 1980s.

Table 3.5 Composition of manpower

Nationality	% to Total Manpower	Number of Firms
Filipino	100	5
Foreigner	<10	2
Total		7

Development Strategies of the Companies

A. Markets

Reasons for starting business. Having good markets for their products and high profitability were the most common reasons for starting business (Table 3.7). The low cost of production in the Philippines and the creation of employment opportunities for the out-of-school youths and the unemployed in the rural areas were also cited as reasons for starting business.

Table 3.6 Average annual growth rate of employment, by company

Firm	Period	Growth Rate (%)
1	1976-1995	
2	1967-1995	14.6
3	1988-1995	55.8
4	1974-1995	6.2
5	1980-1995	27.5
6	1988-1995	56.3
7	1990-1995	31.6

Branch overseas. Four of the companies have branches overseas and these are all located in Asia (Japan, Korea, Thailand, Indonesia and Malaysia).

Table 3.7 Reasons for starting business

Reasons	Number of Firms
Good market for products	4
Profitability	3
Low production cost in the Philippines	1
Create employment for the out-of-school youths and unemployed in the rural areas	1

Market orientation. Four of the companies are export-oriented in the sense that they export, on the average, at least 50 percent of their outputs (Table 3.8). Only one company was 100 percent export-oriented and another company was almost 100 percent domestic-oriented. A deeper analysis of Table 3.8 shows that all but one company did not change market orientation despite the shifts in the trade regimes the country went through during the past decades. All four export-oriented company have been exporting majority of their outputs since the start of business operation. On the other hand, only 1 of the 3 domestic oriented companies shifted its market orientation from 100 percent domestic market to 80 percent export market.

The role of the size of the domestic market was crucial in the companies' decision to shift to export production. One of the domestic oriented companies does not intend to penetrate the export market since the domestic demand is not even big enough for the company to be able to operate at maximum capacity. On the other hand, one domestic oriented company said that the growth in income in recent years

translates into higher demand for its products. Domestic demand was increasing making its production capacity small compared to the growing domestic market.

Table 3.8 Market orientation

Firm	Domestic				Exports			
	1970-79	1980-89	1990-94	Average	1970-79	1980-89	1990-94	Average
1	5	5	5*	5	95	95	95	95
2	80	85	90	85	20	15	10	15
3	-	99	99	99	-	1	1	1
4	ND	26	45	36	ND	74	55	64
5	-	0	0	0	-	100	100	100
6	-	100	20	60	-	0	80	40
7	-	-	5	5	-	-	95	95
Average	42	52	38		58	48	62	

ND: No data

*Covers the period 1990-93 only since the company went 100% domestic during the appreciation of the peso in 1994.

Nevertheless, the average exports for all the companies went down from 58 percent during the 1970s to less than 50 percent during the 1980s. Exports was highest at 62 percent during the period 1990-94. Furthermore, a comparison between Tables 3.6 and 3.8 shows that the highest employment growth rate was registered by the domestic-oriented companies.

Export markets. The top three export markets vary with the industry the companies belong to. The USA and Japan are the popular destinations of electronics

and electrical products. The USA is also the top export market for garments and ceramics products. On the other hand, handbags and leather products easily find their way to the European countries.

The top 3 export markets of these companies also vary with time. In the 1970s, France is the number one export market (Table 3.9). In the 1980s, USA ranks first while Japan and some European countries come second. In the 1990s, however, Japan shares with the USA the top export markets. Some Asian countries like Malaysia, Singapore and Korea only rank third as destinations of exports. Some companies face constraints in the choice of export markets where the decision is often made by their mother companies.

Subcontracting. Additional employment are generated by the companies through subcontracting. The most common subcontractors are households and small enterprises.

Four of the companies sub-contract parts of the production, ranging from 20 to 75 percent of the production process. One of these 4 companies, however, practices subcontracting of 100 percent of the production process. Subcontracting is often done by providing the subcontractors with all the materials they need. For some companies, a supply accreditation process is done where criteria are first set by the company and the supplier who meets the criteria and gets the highest rating is awarded the contract. The companies also provide subcontractors with support through the supplier assistance program.

Table 3.9 Export markets

Country	1970-1979			1980-1989			1990-1994		
	1	2	3	1	2	3	1	2	3
Japan					1		2		
Taiwan				1					
Singapore					1			1	
Malaysia						1			
Asia (parts of)						1			
USA		1		3			2	2	
France	1			1			1		
Mexico	1							1	
Germany		1							1
Europe					1	1	1		1
Canada						1			1
U.K.					1			2	
Scandinavian Countries			1						
Middle East			1						
Korea									1
Italy									1

Reasons for sub-contracting vary among the companies and these include the following: (1) need to down size factory; (2) less administrative expense; (3) less labor cost; (4) create backward linkages with the rest of the economy; (5) transfer of technology to support industries; and (6) insufficient firm capacity.

B. Strengthening of Competitiveness

All of the companies are very much aware of the increased competition they face with a more liberalized trade and investment regime not only in the country, but also abroad. It is interesting to note, however, that all are preparing themselves to gear up with the changes in the domestic and international trade environments by adopting strategies that would strengthen their market positions and enhance their competitiveness. The companies are embarking on intensive productivity improvement programs and human resource training programs. This section discusses these strategies in 3 areas namely, management, technology and marketing.

Management

(i) *Training.* All sample companies send their production and management staff to trainings. While this has been a practice before, the training programs are being improved and the number of staff sent to trainings are increased to strengthen the companies' productivity and competitiveness in the light of a more open world trading system. The percentage of staff sent to trainings vary among companies. For local trainings, which are mostly in-house company trainings, the percentage ranges from as low as 10 percent to as high as 100 percent of the workforce (Table 3.10). To upgrade the skills and knowledge of the staff to international standards, some of these companies employ foreign consultants to conduct their in-house trainings for the staff.

In addition to local trainings, three of the companies send 5-20 percent of their staff to trainings overseas; and 1 company, 21-35 percent of its staff. Such trainings are usually conducted by their mother companies abroad. The absorptive capability of a staff is very crucial and hence, only college degree holders qualify for overseas trainings. For most of the companies, the amount spent on trainings depends on gross sales, i.e the higher the gross sales, the higher is the amount devoted for trainings.

Table 3.10 Percentage of manpower sent to trainings

Type of Training	% of Manpower Sent to Training	Number of Firms
1. Local Trainings		
	10	1
	30	1
	90	1
	100	3
	no fixed percentage	1
2. Foreign Trainings		
	5-20	3
	21-35	1
	no fixed percentage	1

(ii) Research and development activities. Four of the companies engaged in research and development activities (Table 3.11). It is interesting to note that 3 of these 4 companies are export oriented. These companies considered research

and development activities as necessary for them to remain competitive in the export market. As shown in Table 3.11, most of these R & D activities are on-product development.

The average percentage of budget devoted to R & D activities varies among companies. One company spends 1-2 percent of its budget, another company at 5 percent, another at 6 percent and 1 company spends 0.5 percent of gross sales.

Table 3.11 Research and development

Area of R and D Activities	Number of Firms
Do not conduct R & D	3
Conduct R & D	4
Product development	4
Human resource	1
Marketing	2

(iii) Measures to improve productivity. All of the sample companies have adopted certain measures to improve their productivity in response to changes in the trade and investment environments, both here and abroad. These measures can be classified into two; one is directly related to manpower and another one directly addresses production (Table 3.12).

To increase manpower productivity, companies grant salary increase, promotion or a lump-sum monetary reward for outstanding performance of the staff/workers. Sending staff to trainings is another measure of increasing productivity.

In the area of production, most of the companies adopt quality control, machine balancing and maintenance, and the just-in-time production system strategy to improve productivity. The latter is a strategy where raw materials are not stocked in order to better accommodate a last-minute change in production plans.

(iv) *Constraints in management.* Three of the companies perceived no constraints in management that can possibly affect their competitiveness (Table 3.13). The other four companies, however, perceived that cultural differences between local managers and their foreign counterparts is a constraint that affects management. Company decisions are often left with the foreign managers without consultation with their local counterparts who, in some instances, are more knowledgeable with certain aspects of the company, like local markets. Furthermore, the disparity in the benefits and remuneration between expatriates and their local counterparts hampers the productivity of the local staff.

Technology

(i) *Degree of automation.* In anticipation of the increase in imports due to trade liberalization, all but one company planned to increase the degree of automation

of the production process to improve the quality of their products and hence, strengthen their competitiveness, both in the local and foreign markets.

Table 3.12 Measures adopted to improve productivity

Measures	Frequency
1. Manpower	
Salary incentive	2
Training	1
2. Production	
Quality control	3
Redesigning and Improvement through analysis of line	1
Machine balancing and maintenance	3
Cost-reduction program	1
Just-in-time production system	3

However, one company is constrained by the size of the domestic demand. Automation would require economies of scale in production but the domestic demand is not even big enough to meet the minimum requirements for automation. This is in sharp contrast to the company's branches overseas where economies of scale in production is made possible by the size of domestic demand.

All of the companies planned to acquire machines with higher capacity. However, this is not meant to displace labor but rather to increase production.

(ii) Choice of technology. Volume of production and the possible effects on the environment are the most common factors considered in the choice of technology

(Table 3.14). Consumer taste and cost effectiveness come second. One company, however, is dependent on its mother company for the choice of technology to be adopted.

Four of the companies consider that the technology they used is appropriate considering the country's level of development. The other three companies, however, have to employ a higher level of technology since their target is the export market. For example, washing machines in the Philippines need not have built-in spin dryers. Such type of washing machines cannot penetrate higher end export markets.

Five of the companies will also be introducing new technology to strengthen their competitiveness. These new technologies are designed to improve quality and to increase productivity. The remaining 2 companies, however, would only rely on their mother companies for any new technology.

Technology transfer from foreign companies to their local counterparts vary among companies and measuring it is a difficult task. As mentioned earlier, local staff are sent to the mother company for overseas trainings to facilitate the transfer of technology. License agreement, royalty fee and technology disclosure fee are also some of the ways of ensuring technology transfer.

Within the local plant, the Filipinos' initiative to learn new skills and techniques is very crucial in the transfer of technology because of differences in communication, style of management and work ethics between Filipino workers and

foreign managers. Some foreign production managers, for example, will not initiate to share what they know unless their Filipino counterparts or the subordinate local staff would initiate to inquire.

Table 3.13 Constraints in management that can affect competitiveness

Type of Constraints	Frequency
No Constraints	3
Constraints	4
Cultural differences of managers	1
Decision depends solely on foreign counterpart	1
Fixed mark-up as dictated by mother company	1
Different levels of competence among production and management staff due to policy of promotion from within	1

Table 3.14 Factors considered in the choice of technology

Factors	Frequency
Consumers' taste	2
Trend overseas	1
Volume produced	3
Environment friendly	3
Cost effectiveness	2
Quality improvement	1
Depends on mother company	1

The absorptive capacity of the rank-and-file to learn and master new advanced technology is also important in the transfer of technology. Because of the deterioration in the quality of education in the country, college degrees are now required even for jobs where a high school graduate used to qualify.

(iii) *Quality control.* All of the seven companies felt the need to improve quality control to remain competitive. Ways of improving quality control include the following: (1) quality control enhancement program; (2) top quality management (TQM); (3) improvement of system and training; (4) fast track technology transfer; and (5) standardization of output through mechanization.

(iv) *Constraints in technology.* Four of the companies do not experience any constraints in technology that could adversely affect their competitiveness. The lack of capitalization, however, is a big constraint for two of the companies in their desire to employ the state of the art technology. These companies already felt the threat that greater competition from larger imports, which are cheaper and of better quality, create on their products.

One company, on the other hand, considers the limited choice of technology from its mother company as a constraint that can impair its competitiveness.

Marketing

(i) Shift to new products and markets. With the more liberalized global trade environment, only four of the companies plan to shift to new products; three of these companies are export oriented. In terms of new export markets, only one company plans to look for new markets overseas and these include the lower end export markets, like Vietnam, Bangladesh and India. Two companies, however, intend to look for new buyers in the old markets. One company depends entirely on its mother company for new markets abroad.

Also, only two companies intend to increase their budget for advertising. One company, however, would like to increase its budget for advertising only if the government would allow the inclusion of advertising expense in income tax deductions.

(ii) Constraints in marketing. Several factors seem to stand in the way in the marketing of the companies' products. These include the following: (1) bad impression of the country, especially its peace and order problem; (2) tough competition overseas; (3) marketing support from mother company is irrelevant to present market conditions; and (4) limited experience in the international market.

Policy Environment

Trade Reforms

(i) *EO 470*. Only the domestic oriented companies were naturally adversely affected by EO 470 although the degree of the effects vary among companies, i.e two of them were negatively highly affected while one was negatively slightly affected (Table 3.15 and Table 3.16). The adverse effects took the form of greater competition from cheaper imports. While tariff rates went down, the decrease in tariff for output was relatively higher than the decrease in the tariff for inputs.

The export oriented companies, on the other hand, were either not affected or positively affected because some of them were entitled to duty-free importation of their inputs while others pay lower tariffs on their inputs.

Table 3.15 Market orientation and the effects of selected policies

Firm	Market Orientation	Overall Effect of EO 470	Overall Effect of Foreign Exchange
1	X	Not Affected	Negative
2	D	Negative	Positive
3	D	Negative	Negative
4	X	Not Affected	Negative
5	X	Not Affected	Negative
6	D	Negative	No Effect
7	X	Positive	Negative

Note: X-export oriented
D-domestic oriented

Those who were negatively affected experienced higher cost of production and hence, reduced the scale of their operation. Also, there was a decrease in the demand for their products because of cheaper imports (Table 3.17). The response of the companies to these negative effects varied. Some companies reacted positively by developing new models or technology that would enable them to produce at a lower cost and hence, would allow them to lower the price for their outputs and remain competitive with the cheaper imports (Table 3.18). For other companies, the negative effects resulted to the laying-off of workers.

The export oriented companies, on the other hand, lowered their prices because of the decrease in the cost of their inputs, making them more competitive in the world market.

(ii) Import liberalization. The reduction in quantitative restrictions affected positively, albeit slightly, two of the companies.

Value Added Tax (VAT)

Four of the companies were negatively affected by the value-added tax (two companies as highly affected and another two companies as slightly affected (Table 3.16). An indirect increase in the cost of inputs was the most common negative effect of VAT. While the tax has to be refunded in terms of tax credits, the long period of processing tax credits lowers the value of their money, especially if inflation is high. This in effect increases indirectly the cost of inputs. This creates multiplier effects like reduction in the scale of operation, increased price and hence, a decrease in

demand and sales. The response of the companies was to create lobby groups to present their case to the Congress and such rent-seeking activities also entail additional cost to the companies.

One company, however, was positively slightly affected by VAT. Because of the tax refunds (Table 3.17), prices were lowered and the proportion of exported products was increased (Table 3.18).

Foreign Exchange Policy

All four export oriented companies and one domestic oriented company were highly adversely affected by the fluctuating exchange rate, especially of the recent appreciation of the currency (Table 3.15). The most felt effect of the currency appreciation was the decrease in sales (Table 3.17). The companies found it difficult to make their exports competitive in the world market. Cost of inputs also went up and profits went down. One company experiences a loss in sales of P25 million for every P1 appreciation of the currency. Another company also lost P40 million in sales with the appreciation of the peso in 1994. One company, however, highly benefitted from the appreciation of the peso. The demand for its output increased and hence, the scale of its operation.

Table 3.16 Overall Effects of Policy

Policies	No effect	Slightly Affected		Highly Affected	
		Negative	Positive	Negative	Positive
1. Trade Reforms					
1.1 EO 470	3	1		2	1
1.2 Import liberalization			2		
2. Tax Policy					
2.1 VAT	1	2	1	2	
3. Foreign Exchange Policy					
3.1 Exchange rate changes	1			5	1
4. Financial Liberalization					
4.1 Liberalization of banks (entry of foreign banks)	1				4
4.2 Market determined interest rate				2	2

Table 3.16 Overall Effects of Policy
(continuation).....

Policies	No effect	Slightly Affected		Highly Affected	
		Negative	Positive	Negative	Positive
4.3 Easing of capital controls					1
5. Fiscal Incentives for Eligible Firms					
5.1 Tax credit on importation of raw materials	1	1	2		3
5.2 Tax credit on importation of eqp't	1	1	1		4
5.3 Accelerated depreciation	2				2
5.4 Reduced income taxation for labor use					2
5.5 Income tax holiday					4
6. Labor/Wage					
6.1 Minimum wage	2	1		4	

Table 3.17 Effects of policies on companies

Policies	Negative Effects	Frequency	Positive Effects	Frequency
1. Trade Reforms				
1.1 EO 470	Reduce scale of operation	2	Decrease cost of input	1
	Decrease demand for output	1		
	Increase cost of input	2		
2. Tax Policy				
2.1 VAT	Increase price	1	Tax paid are reimbursed	1
	Decrease sales	1		
	Reduce scale of operation	1		
	Increase cost of input	2		
	Decrease demand for output	1		
	Lost money due to longer processing of tax credit	1		
3. Foreign Exchange Policy				
3.1 Exchange rate changes	Decrease in sales	4	Increase scale of operation	1
	Increase cost of inputs	3	Increase demand on output	1
	Decrease in profit	3		
4. Financial Liberalization				
4.1 Liberalization of banks			Increase scale of operation	1
			Decrease cost of input	2
			(via interest expense)	
4.2 Market determined interest rate	Increase cost of inputs	1	Increase scale of operation	1
	Reduce scale of operation	1	Decrease cost of inputs	1

Table 3.17 Effects of policies on companies
(continuation).....

Policies	Negative Effects	Frequency	Positive Effects	Frequency
4.3 Easing of capital controls			Decrease cost of inputs	1
5. Fiscal Incentives				
5.1 Tax credit on importation of raw materials	Decrease profit margin	1	Increase scale of operation	1
			Decrease cost of inputs	4
			Increase profit	1
5.2 Tax credit on importation of equipment	Decrease profit margin	1	Increase profit	1
			Decrease cost of inputs	2
			Increase scale of operation	2
5.3 Accelerated depreciation	Increase cost of inputs	1	Increase profit	1
5.4 Income tax holiday			Decrease cost of inputs	1
			Higher profit	2
			Increase scale of operation	1
6. Labor/wage				
6.1 Minimum wage	Increase cost of inputs	3	Improve quality of product	1

Table 3.18 Reaction/Response of companies to policies

Policies	Negative Response		Positive Response	
	Response/Reaction	Frequency	Response/Reaction	Frequency
1. Trade Reforms				
1.1 EO 470	Lay-off employees	1	Expedite models that can command lower prices	1
	Increase proportion of imported inputs	2	Lower price	2
2. Tax policy				
2.1 VAT	Raise prices	1	Increase proportion of exported products	1
	Form lobby groups to counteract the effect	1	Lower prices	1
3. Foreign Exchange Policy				
3.1 Exchange rate changes	Lay-off employees	1	Improve productivity	1
	Decrease proportion of exported products	1	Hedging forex positions to prevent opportunity loss	1
	Raise prices	1	Faster delivery date	1
	Hold-off expansion	1	Increase volume of production	1
4. Financial Liberalization				
4.1 Liberalization of banks			Increase proportion of exported products	1
			Institute cost-cutting measures	1
4.2 Market determined interest rate	Raise prices	2	Improve productivity	1
4.3 Easing of capital controls			Institute cost-cutting measures	1

Table 3.18 Reaction/Response of companies to policies
(continuation).....

Policies	Negative Response		Positive Response	
	Response/Reaction	Frequency	Response/Reaction	Frequency
4.4 Development of Stock /capital market			Market liquidity causes interest rates to go down	
5. Fiscal Incentives				
5.1 Tax credit on importation of raw material	Increase proportion of imported inputs	3	Hire new employees	1
			Lower prices	3
			Increase proportion of exported products	1
5.2 Tax credit on importation of equipment	Increase proportion of imported inputs	2	Lower prices	3
			Hire new employees	1
			Improve productivity	1
			Institute cost-cutting measures	1
			Increase proportion of exported products	1
5.3 Accelerated depreciation			Lower tax payment	1
			More investment	1
5.4 Income tax holiday	Increase proportion of imported inputs	2	Lower prices	2
			Increase proportion of exported products	1
			Increase investment	1
			Hire new employees	1
6. Labor/Wage				
6.1 Minimum wage	Lay-off employees	1	Improve productivity	2
	Raise prices	2	Increase proportion of exported products	1
	Hold-off expansion	1		
	Close down (w/ wage increase)	1		

The strong position of the currency generated both positive and negative responses from the companies. The positive response include the following: (1) improvement of productivity; (2) increase volume of production; (3) hedging of foreign exchange position so as to prevent opportunity losses; and (4) faster delivery date of exports. The negative response on the other hand, include the following: (1) lay-off workers; (2) hold-off expansion; (3) raise price and (4) decrease proportion of exported products. One company, for example, decreased its manpower size from 700 to 135 during the appreciation of the peso in 1994.

Financial Liberalization

Financial liberalization in the country, which took the form of allowing the entry of more foreign banks and the easing of capital controls, generated positive effects to most of the companies (Table 3.16). The entry of foreign banks ranks first among those rated to have high positive effects. Since more capital are available, planning for expansion becomes much easier. The most common effect is the decrease in the cost of inputs via the lower interest expense and an increase in the scale of operation of the companies (Table 3.17). On the other hand, the most common response to these changes in the financial system is the improvement of productivity via the institution of cost cutting measures (Table 3.18).

All of the companies (both domestic and export oriented), however, are of the opinion that their future performance, given the changes in the international trade environment, hinge on the support they can get from the government. The localization of parts is a crucial factor to their survival. The absence of local suppliers for much of the intermediate inputs forced companies to rely heavily on imports. This makes the cost of production more expensive. The government is urged to develop support industries who will supply the essential intermediate inputs. One way of doing this is for the government to encourage and direct foreign direct investment into these industries. Although there are existing intermediate input industries, they are not producing internationally competitive inputs, probably due to the high protection accorded them. Most of the companies think that they will be better off if their products will have 50 percent local content.

The development of support industries, however, requires the strengthening of technical education among the labor force. The country is lacking in this type of skills and this is a constraint in the development and growth of support industries.

The government should have definite policies on labor and labor management. Aside from the high minimum wage, the militancy of labor unions is going against the objective of attracting foreign investment. China and recently Indonesia and Vietnam are becoming the country's biggest competitors because of their cheap labor. The government should ensure that any minimum wage adjustment is accompanied by increased productivity of workers. The improvement in the quality of education at all

levels should also be given high priority by the government to increase the competitiveness of workers.

The circuitous procedures in the processing of papers, be it for exports or the importation of intermediate inputs, are a discouragement to the companies. A superior machinery for administering paper requirements and the streamlining of export procedures would greatly reduce the time and cost of the companies in obtaining permits/licenses or in availing fiscal incentives.

Table 3.19 Market orientation and future prospects of selected policies on companies

Firm	Market Orientation	Future Prospects
1	X	Can't determine
2	D	Worse-short term Better-long term
3	D	Worse-short term Better-long term
4	X	Good
5	X	Same
6	D	Worse
7	X	Same

Note: X-export oriented
D-domestic oriented

Tax incentives which promote investment in training and retraining of personnel are inadequate and should be included among the fiscal incentives available to producers.

The sad state of the country's infrastructure particularly roads, power and telecommunications, drive foreign investors away. In this age of cyberspace and information super-highways, a reliable and efficient state of the art telecommunication facilities would greatly facilitate the networking of companies to their mother companies, to their buyers and to their suppliers of intermediate inputs. The efficient networking will in turn lead to lower costs and hence, greater productivity. The construction of good roads and the installation of adequate power supply should also be given utmost priority by the government.

Chapter 4

Trends and Prospects for Philippine - Japan Economic Relations

The long standing economic relations between the Philippines and Japan is a reflection of the close historical, geographical, economic and political links between the two countries. Japan has played an important role in postwar Philippine development and continues to play a significant role in shaping the Philippine economy.

Next to the United States, Japan has remained the country's major market for its exports, the leading source of its imports and the major source of foreign direct investments (FDI). The rapid appreciation of the yen and the structural change in Japan have led to the expansion of Japanese FDI since the second half of the 1980s. Although most of the FDI were directed largely to North America and Europe, the share of East Asia, including the Philippines, started to rise in the 1990s. On the other hand, the Philippines has served as a market for Japanese exports, especially those that arise from the import requirements of Japanese FDI in the country.

Official development assistance (ODA) is another major source of the flow of funds from Japan to the Philippines. In recent years, Japan has already overtaken the USA as a major source of the country's ODA. Most of these funds were channeled to finance public infrastructure projects.

This chapter aims to analyze the trends of the Philippine - Japan economic relations focusing on trade, investments and development assistance and indicates some possible directions regarding the future role of Japan in Philippine development. Of utmost importance is the issue of how the economic relations between the two countries can take a new focus and direction in the light of the globalization of trade and investment and the new stance by which development cooperation among economies is taking shape.

The trends and flows of trade between the Philippines and Japan and the FDI and ODA of the latter to the former are discussed separately in the next three sections. The concerns arising from the trends and the future prospects in each of the three areas are also discussed. The final section deals on the more general issues and challenges for the future relation between the two countries.

Japanese Foreign Direct Investments in the Philippines

Recent trends of Japanese FDI

Next to the USA, Japan has continued to be the major source of FDI in the country. During the period 1970-1994, Japan contributed an average of 8.03 percent to the total investments registered under the Board of Investments (BOI) and 18.21 percent of the total foreign investments in the country (Table 4.1 and Table 4.2). The share of Japan was highest during the period 1985-1990 during which the yen appreciated rapidly due to the Plaza Accord of 1985. The share started to decline however after 1990 following the collapse of the Japanese bubble economy (Figure

4.1). This was also the period, however, when China and Vietnam started becoming attractive alternative sites for FDI not only from Japan but also from other developed countries. This trend is also reflected in Table 4.3 where Japanese FDI registered a negative average annual real growth rate during the period 1990-1994, a big contrast to the 66.4 percent average annual real growth rate during the period 1985-1990. In fact, FDI declined not only in real terms but also in nominal terms in 1994.

While the volume of Japanese FDI is relatively high compared to other foreign investors in the country, the share of the Philippines to the total Japanese global FDI is rather small. During the period 1951-1993, the cumulative share of the Philippines to the total Japanese global FDI is only 0.51 percent (Urata and Tullao 1995:1). Among the ASEAN, the lowest share went to the Philippines during the period 1973-1992 (Table 4.4 and Figure 4.2). Not only was the country's share the lowest, but the share is also declining. This is in sharp contrast to the increasing share of Malaysia and Thailand. Because of the uncertainty of the political situation in the country during the latter half of the 1980s (i.e. People Power Revolution in 1986 and the series of coups during the Aquino administration in 1989), the country was unable to take as much advantage of the rapid growth of Japanese FDI after the Plaza Accord of 1985 as the other ASEAN. Having lost the opportunity of becoming a promising site for Japanese FDI, the country is now confronted with greater competition from China and Vietnam.

Table 4.1 Percentage distribution of total investments, by source, 1970-1994
(per cent)

Type/Source	1970-75	1975-80	1980-85	1985-90	1990-94
Domestic	4.20	60.33	52.75	51.93	58.86
Foreign	45.80	39.67	47.07	48.10	41.16
Asia	13.73	12.85	9.93	25.28	20.78
Hongkong	0.50	0.65	0.80	5.62	3.54
Japan	7.88	7.37	5.90	11.15	7.86
Malaysia	0.72	0.00	0.58	0.17	2.06
Taiwan	2.50	0.38	0.12	5.05	2.70
Rest of Asia	2.12	4.43	2.53	3.30	4.66
Australia & Oceania	1.62	2.43	3.15	1.22	0.28
North America	19.17	12.63	20.37	13.02	7.06
Canada	4.90	0.12	0.17	0.63	0.58
USA	14.22	12.53	20.23	12.37	6.48
Rest of N. America	0.10	0.00	0.00	0.00	0.00
South America	0.00	0.00	0.05	0.97	0.12
Central America	0.17	0.23	1.30	0.32	0.38
Caribbean Region	0.00	0.00	0.00	0.00	2.32
Europe	5.75	10.55	11.95	6.72	7.96
Great Britain	3.82	2.32	3.28	3.12	4.48
Netherlands	0.10	1.13	3.77	1.00	2.00
Rest of Europe	1.85	7.08	4.92	2.58	1.50
Middle East	0.00	0.03	0.05	0.05	0.00
Africa	0.00	0.02	0.17	0.23	0.08
Others	5.27	0.92	0.30	0.57	2.26

Source: Board of Investments, Department of Trade and Industry.

Table 4.2 Percentage distribution of foreign investments, by source, 1970-1994
(per cent)

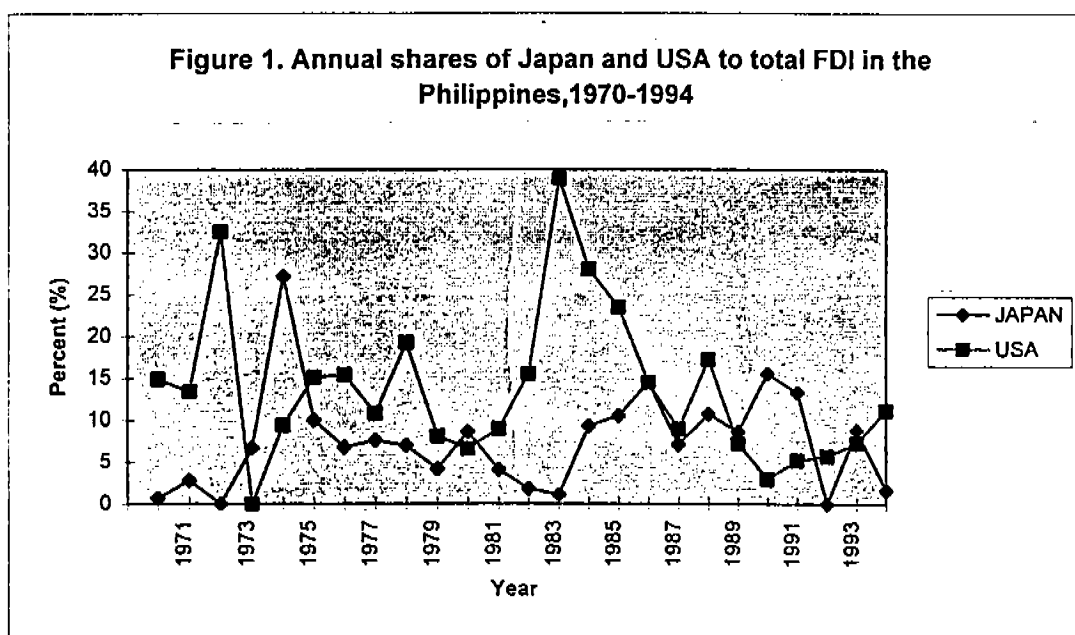
Country	1970-75	1975-80	1980-85	1985-90	1990-94
Asia	28.38	31.57	19.89	52.73	50.09
Hongkong	0.93	1.58	1.39	12.07	8.21
Japan	15.55	18.32	12.29	22.89	22.02
Malaysia	1.33	0.00	0.98	0.37	1.80
Taiwan	6.25	1.02	0.22	10.46	6.37
Rest of Asia	4.28	10.65	5.01	6.96	11.90
Australia & Oceania	3.17	5.90	8.37	2.49	0.56
North America	42.52	31.87	41.30	26.35	18.09
Canada	1.82	0.28	0.30	1.39	1.26
USA	40.63	31.57	41.02	24.96	16.82
Rest of N. America	0.00	0.00	0.00	0.00	0.00
South America	0.00	0.02	0.00	0.00	0.24
Central America	0.52	0.55	2.44	2.87	0.89
Caribbean Region	0.00	0.00	0.00	0.00	5.67
Europe	11.33	27.22	27.07	13.79	18.57
Great Britain	7.62	5.98	7.60	6.29	10.16
Netherlands	0.20	2.73	8.13	2.15	4.87
Rest of Europe	3.53	18.50	11.33	5.35	3.53
Middle East	0.00	0.12	0.21	0.11	0.01
Africa	0.00	0.05	0.37	0.44	0.21
Others	14.10	2.67	0.79	1.23	5.68

Source: Board of Investments, Department of Trade and Industry.

Table 4.3 Average annual growth rate of foreign investment, by source, 1970-1994 (1985 US prices, per cent)

Country	1970-75	1975-80	1980-85	1985-90	1990-94
Asia	66.0	9.4	5.3	83.1	7.8
Hongkong	ND	-34.9	98.7	131.8	8.2
Japan	95.0	25.0	15.8	66.4	-24.0
Malaysia	ND	ND	134.5	136.4	136.1
Taiwan	ND	ND	42.1	194.5	17.2
Rest of Asia	135.0	-17.5	17.7	55.1	25.7
Australia & Oceania	456.0	-28.5	-15.1	96.8	-6.8
North America	16.0	9.7	-21.8	80.1	59.3
Canada	251.0	34.1	-13.9	214.2	-55.5
USA	16.0	9.5	-21.9	61.9	83.0
South America	ND	-88.2	57.1	62.9	-51.4
Central America	ND	-13.8	-47.5	418.0	-74.6
Caribbean Region	ND	ND	ND	ND	114.1
Europe	32.0	80.7	-15.0	9.0	25.8
Great Britain	8.0	48.7	14.5	2.3	16.9
Netherlands	ND	114.0	-21.3	9.1	55.7
Rest of Europe	137.0	85.7	-30.4	21.5	14.0
Middle East	5.0	47.3	20.5	2.0	21.8
Africa	ND	20.9	91.3	39.0	-40.9
Others	-41.0	43.8	-77.5	633.0	67.6
Total	25.0	24.3	0.8	-3.6	-2.3

Source : Board of Investments, Department of Trade and Industry.



Source: Board of Investments, Department of Trade and Industry.

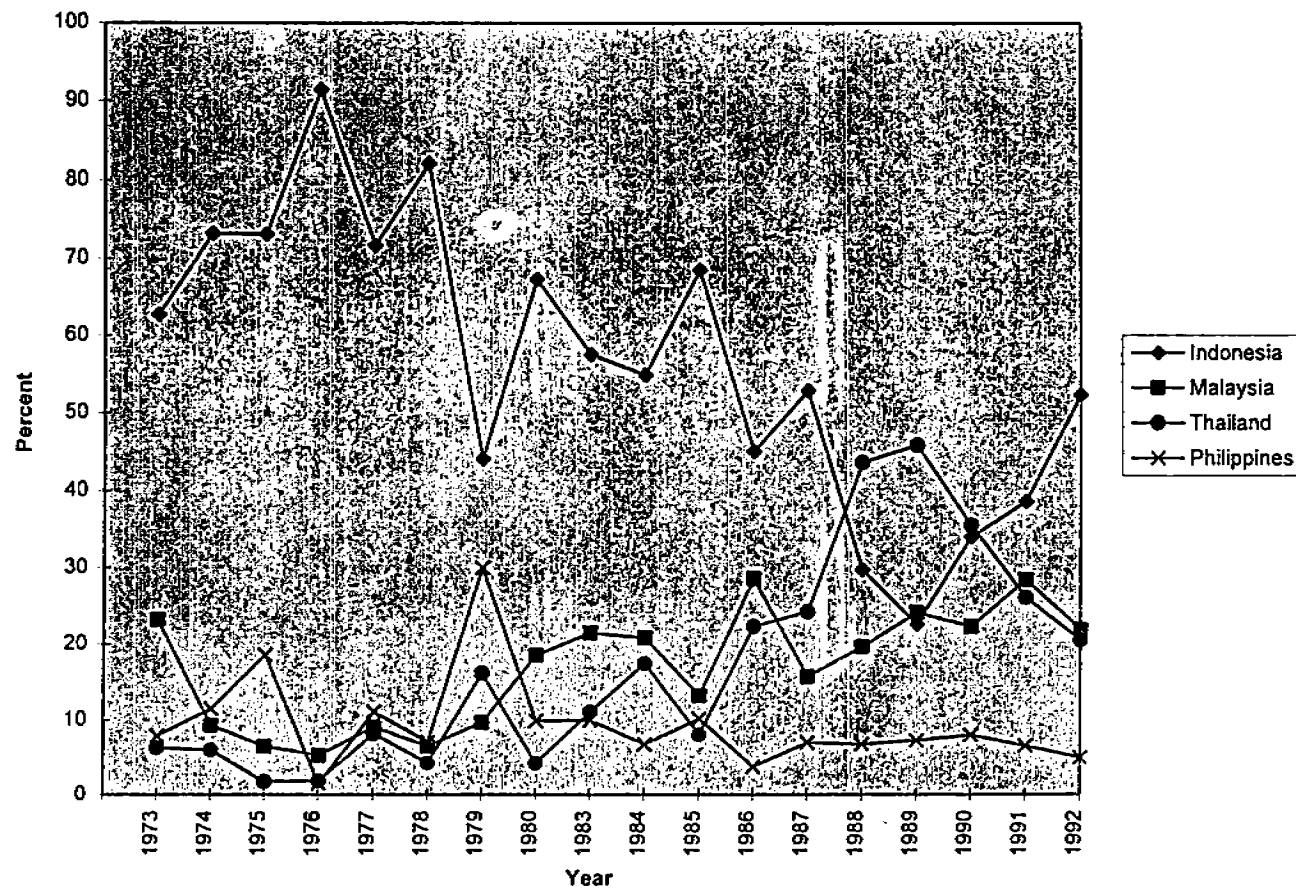
Table 4.4 Percentage distribution of Japanese FDI among ASEAN, 1973-1992
(per cent)

	1973-80	1980-90	1990-92
Indonesia	70.70	48.09	41.73
Malaysia	11.03	20.56	24.30
Thailand	6.11	23.64	27.47
Philippines	12.20	7.76	6.53

Source: Aldaba, R., 1994. "Foreign Direct Investment in the Philippines: A Reassessment", *PIDS Research Paper Series No. 94-10*, Makati, Philippine Institute for Development Studies.

In terms of sectoral allocation, majority of the Japanese FDI in the country went to the manufacturing sector (Table 4.5). The share of the sector has also been increasing since the early 1980s. In fact, the average share of Japan to the total FDI in manufacturing went up from 10 percent in 1981-1985 to 29 percent in 1990-1994.

Figure 4.2 Percentage distribution of Japanese FDI among ASEAN, 1973-1992



Source: Aldaba, R., 1994. " Foreign Direct Investment in the Philippines: A Reassessment ", PIDS Research Paper Series 94- 10, Makati, Philippine Institute for Development Studies.

While this supports the thrust of industrialization for the country, it also reflects the structural transformation in the Japanese economy. As will be discussed below, the yen appreciation forced Japanese companies to locate and expand their operations overseas.

The 1990s, however, show the increasing significance of energy related projects to Japanese FDI. The share of this sector during the period 1990-1994 was three times larger than its share during the period 1981-85 (Table 4.5). This was the result of the built-operate-and-transfer (BOT) scheme adopted by the Ramos administration as a strategy to prevent both domestic and foreign investors from packing up and leaving the country in the wake of the energy crisis in the early 1990s.

Table 4.5 Percentage distribution of Japanese foreign investment, by sector, 1981-1994 (per cent)

Sector	1981-85	1985-90	1990-94
Agriculture, Forestry & Fishery	0.45	2.51	0.43
Mining	11.44	1.21	0.59
Manufacturing	54.42	76.44	79.16
Energy Related Projects	3.50	4.53	10.91
Public Utilities	0.00	0.01	0.11
Export Trader	0.86	0.25	0.02
Service Exporter	0.10	0.07	0.12
Tourism Oriented Services	0.00	1.58	3.79
Infrastructure/Ind'l Services	0.00	0.63	0.90
Research & Development	0.00	0.00	0.98
Commerce (others)	4.87	1.96	0.34
Service (others)	15.01	8.16	0.63
Construction	8.26	1.77	1.71
Financial Institution	0.53	0.01	0.01
Real Estate	0.13	0.88	0.28
Regional Headquarters	0.01	0.43	0.02

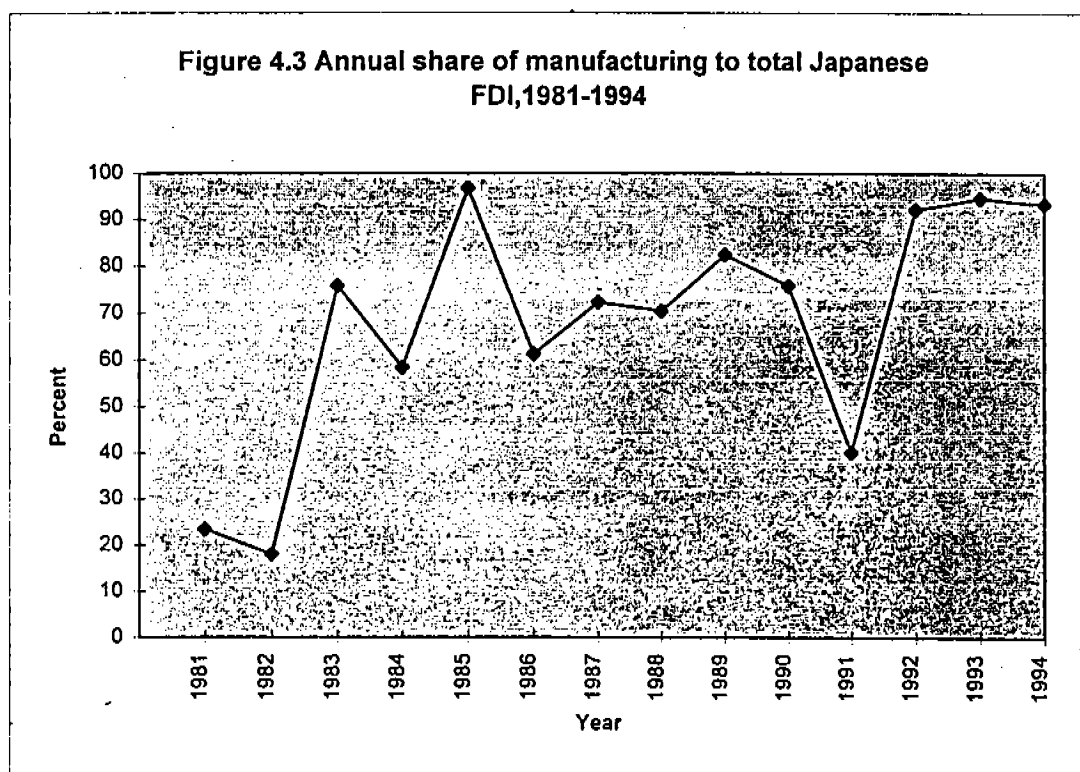
Source: Board of Investments, Department of Trade and Industry

Changing investment environment

Several factors emanating from both the Philippines and Japan contributed to the recent increase in Japanese FDI in the country. On the part of Japan, the structural transformation brought about by the rapid appreciation of the yen, the shortage in labor and surge in wage rates pushed Japanese investors to operate overseas. The yen appreciation, in particular, lowered the price competitiveness in the world market of products produced in Japan. This forced Japan to go global in its production strategy to defend its export markets. Also, the high cost of labor in Japan gave rise to the emergence of the so-called inter-process, intra-firm and intra-industry trade where the production process is divided into a number of sub-processes and each sub-process is located in a country where it could be performed most efficiently or with the least cost.

On the part of the Philippines, tariff protection was found to be one of the significant positive determinants of Japanese FDI until the mid-1980s (Aldaba 1994). Japanese investments tend to converge in highly concentrated manufacturing industries nurtured by high protection walls, like the transport and electrical machinery industries. In fact, Japanese firms in the country have market power in these industries (Tecson 1995).

However, starting in the late 1980s, several factors changed the overall domestic business climate which in turn, attracted new foreign investments into the country. While increasing trade barriers attracted FDI until the early 1980s as discussed above, the reduction in trade barriers motivated FDI starting the late 1980s.



Source: Board of Investments, Department of Trade and Industry

During the early phase of the tariff reform and import liberalization programs, not all commodities/industries were included in the reduction of tariff rates and the removal of import restrictions. In the 1990s, however, the process of liberalization has spread to more sectors and industries. Trade liberalization, while it lowered protection of domestic industries, enhanced the competitiveness and efficiency of manufacturing industries making it more attractive for foreign investors to invest in the country (Medalla et al. 1995). As shown in Figure 4.3, the share of manufacturing in Japanese FDI increased in the 1990s. Also, recent trends show that new Japanese FDI are directed towards export oriented industries (Tecson 1995).

The rules governing foreign investment were also simplified. The Foreign Investment Act (FIA) of 1991, for example, allowed foreign equity participation up to 100 percent in all areas not specified in the Foreign Investment Negative List. In June 1994, negative list C for foreign investment was abolished allowing 100 percent foreign ownership for importers, wholesalers and licensed service operators who have in the past been allowed a maximum of 40 percent foreign equity.

The government also intensified its efforts in deregulating its industries. Monopolies were dismantled and government corporations were privatized. Banks were also liberalized allowing the entry of foreign banks. Infrastructure, especially in the energy sector, was also greatly improved through the BOT scheme.

Future prospects and concerns

Sustaining the flow of Japanese FDI in the country in the 1990s and beyond poses a great challenge to the Philippine government. While the appreciation of the yen is expected to continue, other developing countries, like China and Vietnam, are fast becoming alternative host countries to Japanese investors. In fact, investments not only from Japan but also from the Newly Industrializing Economies (NIES) have been directed to these countries in recent years (Takeuchi 1995).

Global competitiveness is the name of the game for the rest of the 1990s and beyond as WTO, APEC, AFTA and other regional trading blocs take a major role in directing the flow of trade and investments in the world. While global competitiveness has been adopted as the country's development vision during the

Ramos administration, the government's efforts in the attainment of this vision should be sustained and enhanced. It is not enough that Japan remains the country's major source of FDI. Efforts should be geared now towards increasing the share of the country to the total Japanese global FDI. One way of achieving this is for the government to forge ahead with further deregulation and liberalization. The attraction of the country as an investment site will therefore no longer be based on a highly protected domestic market but on efficiency, productivity and competitiveness in the world market.

The orientation and direction of Japanese FDI will depend on the policy changes in the Japanese economy and the policy orientation of the host country. Take the case of the Japanese consumer electronics industry. Prior to the yen appreciation, the Japanese electronics industry succeeded in the assembly type of production in its operations overseas where components are produced in Japan and assembled overseas. However, the appreciation of the yen increased the cost of producing components in Japan. With this development, production of components are now directed to the Newly Industrializing Economies (NIEs). The Philippines should take advantage of the situation by making the country as an attractive site for assembly operations for export production. In the long run, however, the country should orient its policies towards the transformation of labor intensive industries into higher value added industries and the promotion of high technology industries.

With the relocation of export oriented Japanese firms, there is a pressing need to expand local procurement of raw materials and parts in order to maintain their

competitiveness. The lack of these types of support industries is often cited as a negative factor for foreign investments in the country. The proximity of these type of industries with the final goods industries lower production costs and facilitate the production process that could lead to higher productivity. The government should therefore nourish the development and growth of these types of industries.

Expansion of areas open to foreign investment can further attract the flow of Japanese FDI into the country. Aside from the encouraging FDI in the intermediate goods industries, infrastructure development is another area which the government can offer to Japanese FDI. In fact, the construction of public infrastructure through the BOT scheme has already been providing business opportunities in the country. This BOT scheme proved to be strategic in the absence of sufficient public funds to meet the infrastructure requirements of both domestic and foreign investments as shown by the success in solving the energy crisis in the early 1990s. Such can be extended to the telecommunications and transportation industries.

Philippines' Trade With Japan

Exports and imports performance

Japan has remained as the country's major trading partner, next to the USA (Table 4.6 and Table 4.7). For the period 1970-1994, 24.3 percent of the country's total exports went to Japan, although the share has been declining since the 1970s (Table 4.8). Majority of these exports are food stuff and raw materials. These commodities accounted for 71.5 percent of the total during the period 1982-1994 (Table 4.9). It is interesting to note from Table 4.9, however, that exports of manufactured products, particularly articles of the heavy industries, started to gain prominence in the 1990's. For the period 1990-1994, the share of these products to the country's exports to Japan reached an average of 25.2 percent.

On the other hand, 22.6 percent of the country's total imports came from Japan during the period 1970-1994 (Table 4.8). The share of Japan to the country's imports was on a down trend during the 1970s. Although the share started to increase in the 1980s up to the 1990s, the share was still below its level during the 1970s. The bulk of these commodities (81.3 percent) are articles of heavy industry (machinery and equipment and metal products) (Table 4.10).

Table 4.6 Percentage distribution of Philippine exports, by country of destination, 1970-1994 (per cent)

Country	1970	1975	1980	1985	1990	1994
United States	41.43	28.95	27.44	35.73	37.81	38.17
Japan	39.64	37.71	26.49	18.90	19.74	14.96
European Econ Community	8.00	16.17	16.95	13.59	17.69	17.08
France	0.28	0.78	1.64	1.88	1.76	1.37
Germany	1.88	2.96	4.41	3.78	4.76	4.94
Netherlands	4.14	6.97	6.32	3.13	4.36	3.83
United Kingdom	1.04	2.44	2.52	3.61	4.28	4.74
Italy	0.28	0.35	1.16	0.63	0.75	0.67
Others	0.38	0.57	0.90	0.56	1.78	1.53
Middle East Countries	0.28	2.18	2.00	1.53	1.58	1.76
Iraq	0.00	0.00	0.85	0.04	0.00	0.00
Iran	0.00	1.74	0.09	0.13	0.02	0.01
Kuwait	0.00	0.04	0.09	0.13	0.07	0.07
Saudi Arabia	0.00	0.13	0.47	0.84	0.78	0.44
Bahrain	0.00	0.00	0.02	0.02	0.02	0.00
Others	0.28	0.26	0.50	0.37	0.67	1.25
ESCAP Countries	6.12	7.85	16.03	19.92	15.59	19.24
ASEAN	1.22	2.66	6.51	11.47	7.15	10.17
Indonesia	0.19	0.87	1.85	0.39	0.75	0.54
Malaysia	0.09	0.22	1.62	3.85	1.55	1.64
Singapore	0.66	1.39	1.95	6.93	2.93	5.26
Thailand	0.28	0.17	1.09	0.19	1.91	2.71
Brunei	0.00	0.00	0.00	0.02	0.01	0.02
Other ESCAP Countries	4.90	5.19	9.52	8.45	8.44	9.07
Australia	0.47	1.38	1.69	1.73	1.17	1.03
Hongkong	1.04	1.22	3.32	4.04	4.03	4.85
South Korea	2.92	0.65	3.51	1.56	2.81	2.17
New Zealand	0.00	0.04	0.07	0.35	0.11	0.12
India	0.09	0.22	0.28	0.35	0.02	0.10
Brunei	0.00	0.09	0.05	0.00	0.00	0.00
Others	0.38	1.57	0.60	0.43	0.29	0.80
Socialist Countries	0.00	1.57	4.42	2.66	1.01	5.52
China	0.00	1.09	0.78	1.73	0.76	4.59
USSR	0.00	0.44	3.28	0.71	0.18	0.15
Romania	0.00	0.00	0.07	0.00	0.01	0.01
Others	0.00	0.04	0.29	0.22	0.06	0.77
Other Countries	4.52	5.58	6.67	7.67	6.58	3.27

Source: CB Selected Philippine Economic Indicators Yearbook (various years).

**Table 4.7 Percentage distribution of Philippine imports, by country of origin,
1970-1994 (per cent)**

Country	1970	1975	1980	1985	1990	1994
United States	28.90	21.80	23.11	25.08	19.24	18.50
Japan	31.65	27.93	19.81	14.38	18.88	24.36
European Econ Community	16.24	12.40	10.70	8.32	11.10	10.31
France	1.65	1.79	1.15	1.41	1.23	1.10
Germany	5.87	3.82	4.18	2.78	4.33	3.58
Netherlands	1.93	1.30	1.46	0.82	1.38	1.31
United Kingdom	4.31	3.61	2.33	2.02	2.02	1.83
Italy	1.38	0.87	0.84	0.63	0.72	0.78
Others	1.10	1.01	0.74	0.67	1.43	1.71
Middle East Countries	5.05	17.46	21.12	12.40	11.46	7.39
Iraq	0.00	0.75	2.55	0.00	0.41	0.00
Iran	2.20	0.90	0.00	1.12	1.01	0.32
Kuwait	1.93	4.11	5.25	4.30	1.58	0.38
Saudi Arabia	0.83	10.70	10.30	5.24	4.44	4.45
Bahrain	0.00	0.64	1.31	0.00	0.03	0.00
Others	0.09	0.38	1.71	1.74	3.99	2.24
ESCAP Countries	11.93	12.69	15.45	26.57	24.13	26.52
ASEAN	5.23	5.00	6.25	14.75	9.66	11.59
Indonesia	2.39	1.82	2.30	3.62	1.48	1.72
Malaysia	2.39	1.56	2.04	7.24	2.21	2.02
Singapore	0.37	0.61	1.64	2.62	3.96	6.76
Thailand	0.09	1.01	0.26	0.98	1.11	0.93
Brunei	0.00	0.00	0.00	0.29	0.89	0.16
Other ESCAP Countries	6.70	7.69	9.20	11.82	14.47	14.93
Australia	4.59	3.64	2.78	3.11	3.00	2.74
Hongkong	1.10	0.95	2.51	3.87	4.51	5.15
South Korea	0.09	0.35	1.77	3.99	3.89	5.19
New Zealand	0.64	0.95	1.00	0.51	0.72	0.60
India	0.28	0.29	0.14	0.10	0.62	0.61
Brunei	0.00	0.00	0.71	0.00	0.00	0.00
Others	0.00	1.50	0.28	0.23	1.73	0.64
Socialist Countries	0.00	1.82	3.17	5.89	2.06	9.94
China	0.00	1.36	2.67	5.40	1.32	7.13
USSR	0.00	0.00	0.27	0.22	0.21	0.87
Romania	0.00	0.14	0.03	0.12	0.10	0.05
Others	0.00	0.32	0.21	0.16	0.43	1.89
Other Countries	6.24	5.90	6.63	7.36	13.13	2.97

Source: CB Selected Philippine Economic Indicators Yearbook (various years)

Trade deficit

The average ratio of exports to imports during the period 1970-1994 was below 1 indicating a trade deficit (Table 4.8). This is easy to see from the type of commodities exported to and imported from Japan. As presented earlier, exports to Japan are commodities of low value added while imports from Japan are manufactured commodities of high value added which are usually the import requirements of Japanese FDI. This supports the common argument in the literature that while Japanese FDI increases the country's exports, it also increases at a much faster rate, imports from Japan. As shown in Table 4.11, the rapid increase in Japanese FDI after 1985 as discussed earlier is also accompanied by higher growth rates of imports during the same periods. So long as Japanese FDI will depend on imported parts and components, then Japanese FDI will always contribute to the country's trade deficit.

On the other hand, there is a widespread perception of a restricted market access to Japan not only for exports from the Philippines but from developing countries in general. The situation is a contributory factor to the country's trade deficit. While Japan is the second major destination for the country's exports, the share of the country to Japan's total imports is less than 1 percent for most of the period during 1980-1993 (Table 4.12). Non-tariff barriers to exports from developing countries, including the Philippines, are relatively high.

To improve on the trade relation between the two countries, there should be a concerted effort on both countries. On the one hand, the Philippines should increase

its efforts in developing its parts and components industries so that Japanese FDI will no longer depend on imported intermediate inputs. The competitiveness of high value added manufactures should be improved in order to increase further the share of these products to the country's total exports to Japan. On the other hand, Japan should make a deliberate effort to reduce its trade barriers to imports from the Philippines.

Table 4.8 Share of Japan in Philippine exports and imports, 1970-1994 (per cent)

	Exports	Imports	Ratio of Exports to Imports
1970-75	36.12	30.28	1.10
1975-80	26.91	24.91	0.80
1980-85	21.62	17.22	0.98
1985-90	18.97	17.26	0.93
1990-94	17.58	21.25	0.57
1970-94	24.27	22.55	0.87

Source: CB Selected Philippine Economic Indicators Yearbook (various years)

Table 4.9 Percentage distribution of Philippine exports to Japan, by commodity, 1982-94 (percent)

Commodity	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Food Stuff	25.73	28.36	31.77	34.89	43.84	40.46	35.38	33.97	31.58	28.36	31.48	33.57	29.25
Raw Materials & Fuel													
Raw material not for food	53.64	58.16	46.97	44.71	37.47	46.23	44.08	47.26	39.43	23.25	23.48	20.69	19.46
Mineral fuels	1.35	3.61	3.33	0.39	0.87	2.39	3.34	3.05	3.38	3.81	4.49	3.41	2.23
Manufactured Products													
Art. of the light ind.	7.82	9.68	3.19	3.20	3.83	6.10	5.72	7.48	8.70	8.36	10.04	11.95	11.31
Art. of the heavy ind.	7.83	9.24	13.68	16.39	13.03	4.40	4.82	7.71	13.75	21.04	26.34	28.21	36.57
Special Commodities: Re-exports	3.63	0.95	1.07	0.43	0.95	0.42	6.66	0.54	3.15	15.17	4.16	2.18	1.18

Source: JETRO, Japan Import by Commodity, 1982-1994.

Table 4.10 Percentage distribution of Philippine imports from Japan, 1982-94 (percent)

Commodity	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Food Stuff	1.98	0.49	0.27	0.82	1.44	2.11	3.01	1.98	1.36	1.14	0.65 ⁺	0.72	0.64
Raw Materials & Fuel													
Raw materials not for food	0.51	0.58	0.56	0.50	3.44	2.85	2.80	2.38	2.44	1.79	2.00	1.11	1.03
Mineral fuels	1.26	0.90	1.95	1.29	1.59	1.54	1.04	0.89	1.69	1.87	1.37	2.31	2.64
Manufactured Products													
Art. of the light Ind.	13.84	12.43	16.48	18.66	19.81	16.21	14.53	11.70	10.44	11.65	9.09	6.99	5.91
Art. of the heavy ind.	81.59	84.67	79.23	77.31	72.82	76.13	77.58	82.04	82.82	81.48	85.49	87.87	88.42
Special Commodities: Re-exports	0.82	0.93	1.52	1.42	0.91	1.16	1.03	1.01	1.24	2.07	1.40	0.99	1.37

Source: JETRO, Japan Export by Commodity, 1982-1994

Table 4.11 Average annual real growth rate of exports to and imports from Japan, 1970-1994 (1985 prices, per cent)

Year	Growth Rate	
	Export	Import
1970-1975	9.99	12.33
1975-1980	2.06	3.97
1980-1985	-15.38	-18.26
1985-1990	9.01	20.41
1990-1994	3.17	20.55

Source: Philippine Statistical Yearbook, (various years).

Table 4.12 Share of Philippines to total Japanese imports, 1980-1994 (per cent)

Year	Share
1980	2.02
1983	1.03
1984	0.78
1985	0.97
1986	0.96
1987	0.90
1988	1.09
1989	0.98
1990	0.92
1991	0.99
1992	1.00
1993	0.99
1994	0.96

Source: JETRO, Japan Foreign Trade.

Official Development Assistance

Importance of Japanese ODA in Philippine Economic Development

Japan has always been a major donor of official development assistance (ODA) to the Philippines since after the war. ODA comes in the form of either loans or grants and technical assistance. Because of its economic potentials as source of raw materials and destinations of Japanese exports and overseas investments, the ASEAN in general has always been given priority in Japanese ODA as part of Japan's efforts to stabilize and expand her economic ties in the South East Asian region. In fact, the Philippines is among the top 10 recipients of Japanese ODA since 1970 (Table 4.13).

Table 4.13 Share of Philippines to Japan's total ODA (per cent)

Year	Japan's ODA to top 10 Recipient Countries		Japan's ODA to all Recipient Countries		Rank of Philippines
	Total Amount (\$m)	Share of Phil. (%)	Total Amount (\$m)	Share of Phil. (%)	
1970	360.20	5.3	371.51	5.2	5
1975	661.08	10.6	850.40	8.3	3
1980	1,423.68	6.6	1,960.80	4.8	7
1989	4,174.25	9.7	6,778.50	6.0	4
1990	4,246.69	15.2	6,939.56	9.3	3
1991	5,490.69	8.4	8,870.24	5.2	5
1994	5,444.00	10.8	9,559.00	6.2	4

Source: Japan Institute of International Affairs, 1992. "White Papers of Japan 1990-91", *Annual Abstracts of Official Reports and Statistics of the Japanese Government*, Tokyo, Japan :.

Table 4.14 Japan's ODA to the Philippines, 1970-1994 (US\$ million)

Year	Grant Assistance	Technical Assistance	Total Grants	Loans	Total ODA
1970	14.34	1.40	15.74	3.49	19.23
1971	22.80	1.50	24.30	5.33	29.63
1972	36.13	2.12	38.25	65.24	103.49
1973	67.21	3.17	70.33	71.20	141.58
1974	28.53	4.49	33.02	40.30	73.32
1975	30.61	5.64	36.25	34.08	70.33
1976	20.01	6.61	26.62	48.92	75.54
1977	2.73	11.05	13.78	16.83	30.61
1978	9.79	15.40	25.19	41.28	66.47
1979	14.26	17.65	31.91	57.25	89.16
1980	17.91	17.80	35.71	58.69	94.40
1981	23.32	21.65	44.97	165.03	210.05
1982	22.12	22.97	45.09	91.29	136.38
1983	35.84	26.13	61.97	85.05	147.02
1984	26.39	31.30	57.68	102.39	160.07
1985	39.96	29.75	69.71	170.29	240.00
1986	41.08	39.30	80.37	357.58	437.96
1987	66.89	44.90	111.79	267.60	379.38
1988	70.40	60.70	131.10	403.62	534.72
1989	115.32	60.74	176.06	227.69	403.75
1990	91.15	61.98	153.14	494.31	647.45
1991	110.19	63.43	173.62	285.30	458.92
1992	112.34	73.32	185.66	845.01	1,030.67
1993	158.23	87.19	245.42	512.96	758.39
1994	138.41	108.15	246.56	342.78	589.35
Total 1970-1994					
	1,315.96	818.34	2,134.29	4,793.56	6,927.87

Source: Takahashi, A. 1995. *Japan's Development Cooperation in the Philippines*, Paper presented during the Yuchengco Institute RP-Japan Conference, Metro, Manila.

During the period 1970-1994, total ODA from Japan reached US\$6,927.87 million (Table 4.14). Rapid increases in ODA were registered after 1985 due to the unprecedented current account surpluses as a result of the appreciation of the yen. Japan's commitment to support the Aquino administration can also be seen from the large increase in ODA in 1986 from the previous years. The economic disasters

experienced in the country in the 1990s also prompted the Japanese government to increase its ODA. As shown in Table 4.15, the average annual growth rate of Japan's ODA has been increasing, except during the period 1990-1994 when global ODA has declined because of the world recession. Also, the annual share of Japan to the total ODA to the Philippines has been increasing and has in fact overtaken the USA (Figure 4.4).

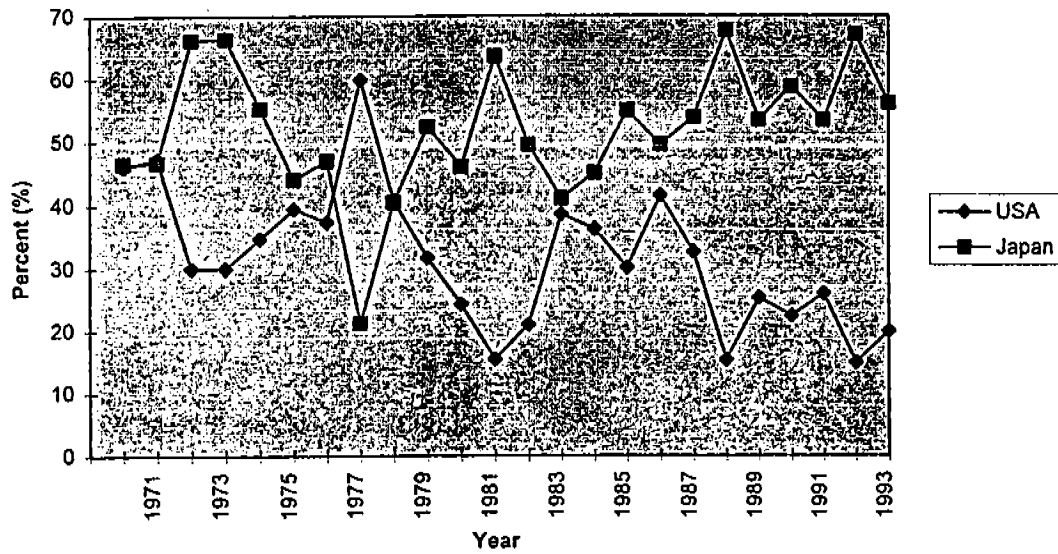
As of 31 March 1995, the cumulative total of ODA loan commitments to the Philippines reached 1,178.9 billion yen (Figure 4.5). The bulk of these loans went to commodity loans (28.7%), transportation (22.5%) and electric power and gas (20.4%).

**Table 4.15 Average annual real growth rate of Japan's ODA to the Philippines
1970-94 (1985 US prices, per cent)**

Year	Growth Rate
1970-74	63.9
1975-79	10.2
1980-84	13.6
1985-89	22.8
1990-94	18.0

Source: Takahashi, Akira, 1995. "Japan's Development Cooperation in the Philippines," Paper presented during the Yuchengco Institute RP-Japan Conference, Metro, Manila.

Figure 4.4 Annual share of Japan and USA in total ODA to the Philippines, 1970-1993



Source: Takahashi, A. 1995. *Japan's Development Cooperation in the Philippines*, Paper presented during the Yuchengco Institute RP-Japan Conference, Metro Manila.

Loan-Grant mix

Japan's ODA has a relatively high proportion on loan financing in contrast to its grants component (Table 4.16). This trend is also true in Japan's ODA to other developing countries. Japan has often been criticized for this by both receiving countries and fellow donors on the argument that loan financing are to be repaid and hence, does not involve a complete transfer of resources.

Table 4.16 Percentage distribution of Japan's ODA, by type, 1970-1994 (per cent)

	GRANTS	LOANS
1970-74	59.1	40.9
1975-79	41.1	58.9
1980-84	34.1	65.9
1985-89	29.0	71.0
1990-94	30.7	69.3

Source: Takahashi, A. 1995. *Japan's Development Cooperation In The Philippines*, Paper presented during the Yuchengco Institute RP-Japan Conference, Metro Manila

This common trait of Japanese ODA can be explained in two ways. First, Japan's objectives in granting foreign aid has changed through time and there is a growing emphasis recently on the need for self-reliance on the part of the recipient countries. Grant aid has been argued to build tendencies of dependence to the donor and in some instances, mutual respect between the donor and recipient countries has deteriorated. Second, the distribution and nature of Japan's aid to developing countries, particularly in Asia, has changed in step with economic development in the region. Some countries of East and Southeast Asia who have achieved a certain level of development are eliminated from the list of recipient countries. For example, South Korea in 1990 has been terminated from the list of ODA loan recipients, marking the country's graduation from aid recipient to aid donor. As the other ASEAN catch up with the NIEs, the pattern of ODA to these countries will shift

giving more emphasis on loans and technical assistance. The Philippines, being on the lower end of the ASEAN in terms of level of development, will likely continue to be included in Japan's ODA program.

Future directions

Economic growth in the country has taken a different turn in the 1990s and the outlook for the rest of the 1990s seems bright and promising. The direction and mode of Japan's ODA will also change reflecting this change in the growth pattern. Which sectors should ODA be allocated to is a crucial issue to look at. There are now strong demands for assistance in areas such as regional development and environmental conservation and protection. Also, more emphasis should be given to social services and social infrastructure. As shown in Figure 4.5, social services only got 5.8 percent of the total accumulated loans in the past.

While the present government had initially succeeded in the private sector BOT scheme for some of its infrastructure projects, there is now a growing debate whether infrastructure projects should be left with the private sector and ODA should be used solely for social development. However, looking at the country's situation where the infrastructure sector needed much development and upgrading in order to attract foreign investors, the government should prioritize the sectors for ODA allocation. The danger of leaving infrastructure development to the private sector lies in the fact that the infrastructure will not be forthcoming until the private investment has been arranged. This is not meant, however, to discard the role of the private sector in providing the much needed infrastructure. The private sector has always been

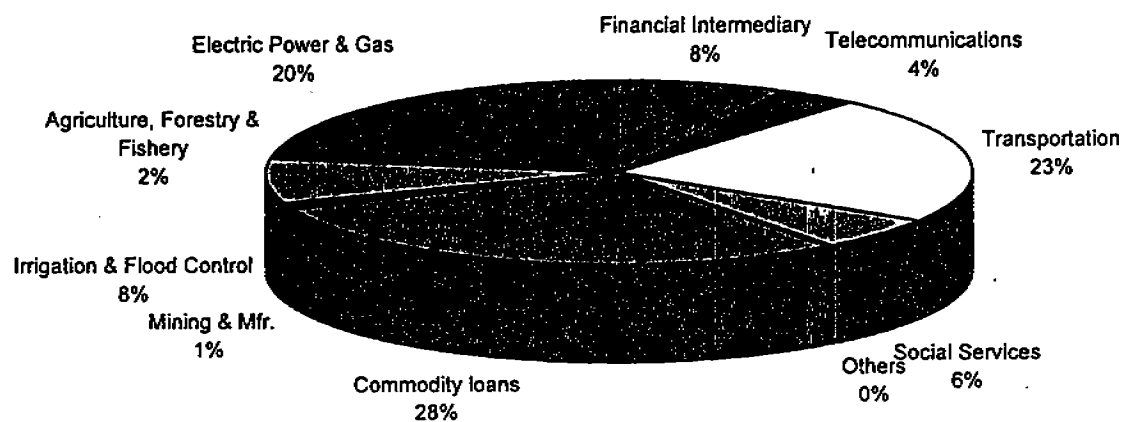
encouraged to work in partnership with the government for the development of the country. It is a matter of prioritization on the part of the government-as to which sectors should be given emphasis on ODA allocation.

Specific infrastructures that should be given priority include transportation, telecommunications, roads and power. Assistance in the development of the power sector should continue because of the expansion in the demand for energy that has accompanied economic growth in recent years. Also, in this age of cyberspace, world class telecommunication facilities are a necessity for the business operations of foreign investors.

Issues and Challenges for the Future

Japan will continue to play a significant role in Philippine development. However, recent developments in the regional and international arena will help shape and determine the future direction of the relationship between the two countries. For one, the Asia - Pacific region where the Philippines and Japan are located, is now undergoing transformation with the implementation of APEC and the individual member economies themselves are undergoing transformation.

Figure 4.5 ODA Loan Commitments to the Philippines, by sector (as of March 31, 1995)



Source: The Overseas Economic Cooperation Fund, 1995. The Overseas Economic Cooperation Fund (OECF) Annual Report 1995, Japan; OECF.

The general principles governing APEC will define and set the direction for the future relationships between and among the member economies. Development cooperation, for example, is slowly taking a new meaning and definition. In line with the rapidly changing nature of economic and political relations among APEC economies, development cooperation is no longer seen as one-way flows of assistance from developed to developing economies. Whereas before, the relationships between developing and developed countries were dictated by certain circumstances such as North-South relations, haves-have nots relations and donor-recipient relations, development cooperation is now being re-defined in the context of equal partnership in development and a new approach that stresses empowerment of all the participants in the development process. Development cooperation no longer implies the transfer of resources but the pooling of resources which include not just financial resources but also expertise, technology, information and experience.

The Philippine - Japan relation will therefore be moving towards this direction. Because of this, there will be institutional changes in both countries that would eventually lead the relationship towards this new direction. How long would it take the two countries to reach this kind of relationship will largely depend on the success of APEC itself.

Another crucial factor to the future of the Philippine - Japan relation, although still within the framework of APEC, lies in the capacity of the Philippines to absorb ODA and FDI from Japan. With the APEC principles governing trade and investment liberalization and facilitation, trade and investments can now be expected to move more freely among the APEC member economies. For the Philippines to

benefit from this, the country should enhance its preparedness to absorb incoming investments and other flow of funds. Japan may have huge funds and would want to direct this to the country; but direct investment is affected by many factors (e.g. economic environment, political stability, peace and order situation, etc.) other than the availability of funds. The preparations can take longer time and the country should better gear up if it were to benefit from the situation; otherwise, it will again be unable to take as much advantage as the other ASEAN.

Suffice it to say however, that the APEC principles are being set in place to help guide the future relations between the two countries.

Chapter 5

Summary and Conclusions

Like many other developing countries, industrialization has been a major development goal of the Philippines. The overall industrial policy of the country was geared towards the promotion of trade and investment. Since the 1950s, trade and investment policies have played a major role in setting the structure of the economy.

The country adopted a different trade regime during each decade. Until the mid-1980s, the policy climate is reflective of high protectionism in developing countries. Industry incentives have remained distorted by protection which was carried out through import and foreign exchange controls, tariffs, fiscal incentives and the overvaluation of the peso. Fiscal incentives include, among others, income tax holiday and tax free importation of raw materials, equipment and accompanying spare parts.

The trade policy instruments adversely affected the efficient allocation of resources by creating bias in favor of import competing manufacturing industries over exports and agriculture and in favor of consumer goods over capital and intermediate goods. Scarce resources were induced to flow towards the protected sector and away from the potentially more profitable export sector. The high trade barriers also attracted foreign direct investment to the protected sector, especially in the highly concentrated industries. The end result was

an imperfectly competitive industrial structure characterized by unrealized scale economies. The industrial sector of the country consequently lagged behind those of other countries.

Recognizing the adverse effects of protectionist policies, the country opted to undertake major trade reforms in the 1980s and 1990s with the objective of promoting efficiency and competitiveness. Tariff range were narrowed down and import restrictions were reduced. Studies have shown the improvements in the tariff and protection structure as a result of the series of trade policy reforms. The effective protection rate and the variation across industries went down significantly from the pre-reform period. More importantly, the overall competitiveness and efficiency of the manufacturing sector went up. This provides some optimism for the country in the future.

However, while there is a substantial reduction in distortions through the various trade reforms implemented, the reforms in the investment incentives have reintroduced the bias toward capital intensity and industries geared towards the domestic market. Hence, these are areas which the investment incentive system should continue to address in the future.

There were other policy reforms in the 1990s that improved the overall domestic business climate. The rules governing foreign investment were simplified allowing entry and foreign equity participation up to 100 percent in all areas not specified in the foreign investment negative list. This is considered as a major improvement in relaxing rules and regulations governing the entry of FDI and encouraging more FDI inflows. Furthermore, the

liberalization of the financial sector made possible the entry of foreign banks into the country.

The country is faced with several challenges for the rest of the 1990s and beyond. The globalization of trade and investment as a result of the strengthening of the trading system based on GATT/WTO has substantially increased competition in the international market. The country therefore has no choice but to move forward with its liberalization and deregulation in order to improve its international competitiveness and take advantage of the increased opportunities for exports. The early new initiatives to maintain the forward momentum of liberalization can be seen from the policy agenda on further liberalization and deregulation by the current administration. The commitment of the country towards this direction can also be seen from its commitment to the principles of APEC and AFTA.

The country's manufacturing industries are also now preparing themselves to gear up with the changing global trading and investment environment. They are embarking on intensive productivity improvement programs and human resource training programs to enhance their market positions and enhance their competitiveness.

The government's commitment to reduce impediments in economic interchange is expected to induce a substantial acceleration of private interest in the country. The government is expected to play a catalytic role in encouraging and channeling domestic and foreign investments in the support and intermediate goods industries and in the infrastructure sector particularly telecommunications, power, energy and transportation. The improvement

of these kind of infrastructure is conducive to the facilitation of trade and investment in the country.

The attractiveness of the country to foreign direct investment and other flow of funds will now be based on efficiency, productivity and competitiveness in the world market. The aim is to increase the country's share to the global FDI of its major trading partners like the USA and Japan. It is hoped that the country's open trade regime will permit a successful realization of the market-driven strategies of outward orientation and enable the country to catch up with the Asia's tigers.

**A STUDY ON TRADE AND INVESTMENT POLICIES OF
DEVELOPING COUNTRIES: THE CASE OF THE PHILIPPINES**

**A JOINT PROJECT OF THE PHILIPPINE INSTITUTE FOR DEVELOPMENT
STUDIES AND THE INSTITUTE OF DEVELOPING ECONOMIES OF JAPAN**

Objectives of the Survey

1. To determine the effects of trade and investment policies of the country on the performance of firms.
2. To determine how firms have responded to the changes in trade and investment policies.
3. To determine the strategies firms have taken or will take in response to changes in the global trade environment.
4. To determine other policy reforms that will enable firms to cope with the changing global trade environment.
5. To determine if there are factors arising from the trade and investment policies of Japan that facilitate and/or hinder firms' current activities and future plans.



Name of Company : _____

Industry : _____

Address : _____

Telephone Number : _____

Name of Respondent : _____

Position : _____

Date of Interview : _____

I. Firm Structure

1. Business form of firm

a. Upon establishment (please check)

- ☐ Single proprietorship
☐ Corporation
 ☐ Joint venture
 ☐ Subsidiary
 ☐ Others (specify)

- ☐ Others (specify)

b. At present

- ☐ Single proprietorship
☐ Corporation
 ☐ Joint venture
 ☐ Subsidiary
 ☐ Others (specify)

- ☐ Others (specify)

2. Date firm was established : _____

3. Firm size (in terms of capitalization)

3.1 Upon establishment

- ☐ Micro-scale (<P2M)
☐ Small-scale (P2-4M)
☐ Medium-scale (P4-15M)
☐ Large-scale (>P15M)

3.2 At present

- ☐ Micro-scale (<P2)
☐ Small-scale (P2-4M)
☐ Medium-scale (P4-15M)
☐ Large-scale (>P15M)

4. Employee size at present

- | | |
|------------------------------------|-------------------------------------|
| <input type="checkbox"/> < 50 | <input type="checkbox"/> 351 - 500 |
| <input type="checkbox"/> 51 - 100 | <input type="checkbox"/> 501 - 1000 |
| <input type="checkbox"/> 101 - 200 | <input type="checkbox"/> > 1000 |
| <input type="checkbox"/> 201 - 350 | |

5. Composition of manpower

<u>Nationality</u>	<u>% to total manpower</u>
Filipino	_____
Foreigner	_____

6. Current major stockholder/owners of company

<u>Nationality</u>	<u>% Share</u>
Filipino (natural born)	_____
Filipino-Chinese	_____
US	_____
Japanese	_____
Taiwanese	_____
Others (specify)	_____

7. Does your company have branches/subsidiaries overseas?

_____ Yes _____ No

If yes,

Location (specify country or countries) _____

Date of start of operation overseas _____

8. What are your reasons for starting business?

- _____ Good market for products
- _____ Profitable business
- _____ Business inherited from parents/family
- _____ Others (specify)

9. Can you describe very briefly the organizational structure of your company? How many divisions/sections are there? What are the educational attainment of the staff occupying management positions?

10. What are the important factors you consider in the following?(list as many)

10.1 Recruitment of new staff

10.2 Promotion of staff

II. Development Strategy of the Company

A. Products and Market

1. What are your company's major products during the following periods? (Major product is defined as those accounting for at least 80% of total sales)

Name of Major Product	Average Percentage to Total Annual Sales		
	1970-1979	1980-1989	1990-1994

2. What percentage of your total annual sales is generated from domestic sales and exports? If exporting, which countries do you export your products?

Period	Average Percentage to Total Sales		Top 3 Export Markets		
	Domestic	Exports	1	2	3
1970 - 1979					
1980 - 1989					
1990 - 1994					

3. Sub-contracting

a. Do you sub-contract production?

____ Yes ____ No

If Yes, state reasons for sub-contracting.

b. What percentage of production is sub-contracted? _____

c. Who are your sub-contractors?

____ Households

____ Small enterprises

____ Others (specify) _____

d. How is the sub-contracting done?

4. Given the changes in international trade due to APEC, AFTA, NAFTA, WTO, etc., what do you think is the future prospect of your company? Why?

____ Worse

____ Good

____ Same

____ Better

Reasons:

B. Strengthening Competitiveness

1. Management

1.1 Do you send your employees to training programs?

____ Yes ____ No

If yes, (a) What percentage of your manpower attends training every year?

(b) Are these local or foreign training programs?

____ Local ____ Foreign

(c) What percentage of your budget is devoted to manpower training? _____

1.2 What measures do you adopt to improve productivity?

1.3 Do you conduct R&D activities?

☐ Yes ☐ No

If yes, (a) In what area?

- ☐ Product
- ☐ Marketing
- ☐ Human Resources
- ☐ Management
- ☐ Others (specify) _____

(b) What percentage of your budget is spent on R&D activities?

(c) Has there been an increase in the budget for R&D activities during the past four years?

☐ Yes ☐ No

If yes, by how much (% increase)? _____

1.4 What are the constraints in management which negatively affect the competitiveness of your company's products?

1.5 Other measures in the area of management that can strengthen competitiveness

2. Technology

2.1 Do you have plans to increase the degree of automation of your production process?

☐ Yes ☐ No

2.2 Are you going to acquire new machines with higher capacity?

____ Yes ____ No

2.3 On the average, what percentage of manpower is being replaced by the acquisition of a new machine? _____

2.4 In the production division, how many engineers do you employ? In what field of engineering do they specialize?

Field of Engineering

Number of Engineers

2.5 Are you going to introduce new technology?

____ Yes ____ No

If yes, what kind of technology?

2.6 What are the factors you consider in your choice of technology?

2.7 If joint venture, in what way(s) is(are) technology transferred?

2.8 Do you think your choice of technology is the appropriate technology considering the level of development of the country?

____ Yes ____ No

2.9 Are you going to improve quality control?

____ Yes ____ No

If yes, how?

2.10 What are the constraints in the choice of technology which negatively affect the competitiveness of your company's products?

2.11 Other measures in the area of technology that can strengthen competitiveness

3. Marketing

3.1 Are you going to shift to new products?

_____ Yes _____ No

3.2 Are you going to increase budget for advertisement?

_____ Yes _____ No

If yes, by how much (% increase)? _____

3.3 Are you going to look for new markets abroad?

_____ Yes _____ No

If yes, which country(ies)?

3.4 What are the constraints in marketing which negatively affect the competitiveness of your company's products?

3.5 Other measures in the area of marketing that can strengthen competitiveness.

III. Policy Environment

1. Which of the following trade and investment policies affected your company? What are the effects of the policies on your company's performance? What are your response(s) to these in policies?

Policy	Overall Effects on the Company			Effects on Company (a) (Please see list of choices at the end of table)	Reactions/Response (b) (Please see list of choices at the end of table)
	No Effect	Slightly Affected	Highly Affected		
1. Tariff and trade reforms					
1.1 E.O. 470					
Input					
Output					
1.2 Import liberalization					
1.3 Others (specify)					

2. Tax policy					
2.1 VAT					
2.2 Others (specify)					

3. Foreign Exchange Policy					
3.1 Exchange rate changes					

Policy	Overall Effects on the Company			Effects on Company (a) (Please see list of choices at the end of table)	Reactions/Response (b) (Please see list of choices at the end of table)
	No Effect	Slightly Affected	Highly Affected		
3.2 Foreign currency retention limit					
3.3 Others (specify)					

4. Financial liberalization					
4.1 Liberalization of banks (entry of foreign banks)					
4.2 Market-determined interest rates					
4.3 Easing of capital controls					
4.4 Development of stock/capital market					
4.5 Others (specify)					

5. Fiscal incentives for eligible firms					
5.1 Tax credit on importation of raw materials					
5.2 Tax credit on importation of equipment					
5.3 Accelerated depreciation					
5.4 Reduced income taxation for labor use					
5.5 Income tax holiday					

Policy	Overall Effects on the Company			Effects on Company (a) (Please see list of choices at the end of table)	Reactions/Response (b) (Please see list of choices at the end of table)
	No Effect	Slightly Affected	Highly Affected		
5.6 Others (specify)					

6. Foreign Investment					
6.1 60-40% equity sharing					
6.2 Minimum capitalization					
6.3 Others (specify)					

7. Technology					
7.1 R&D Incentives					
7.2 Commercialization of new technology					
8. Labor/Wage					
8.1 Minimum wage					
8.2 Others (specify)					

9. Others (specify)					

(a) Effects on the company (list as many)

1. Decrease quality of products
 2. Improve quality of products
 3. Reduce scale of operation
 4. Increase scale of operation
 5. Increase demand on output
 6. Decrease demand on output
 7. Increase cost of inputs
 8. Decrease cost of inputs
 9. No effect
 10. Others (specify)
-

(b) Reaction/Response (list as many)

1. Institute cost-cutting measures
 2. Improve productivity
 3. Raise prices
 4. Lower prices
 5. Specialize on few products
 6. Diversify into other products
 7. Increase proportion of imported inputs
 8. Decrease proportion of imported inputs
 9. Increase proportion of exported products
 10. Decrease proportion of exported products
 11. Lay-off employees
 12. Hire new employees
 13. Hold-off expansion
 14. Others (specify)
-

2.. Are there any other policy reforms you would like to suggest that would enable you to cope with the changing global trade environment?

____ No and why? _____
____ Yes (specify) _____

3. Are there factors arising from the trade and investment policies of Japan that directly or indirectly facilitate and/or hinder your company's current activities or future plans?

Trade and Investment Policies of Japan	Facilitate (In what way?)	Constraints (In what way?)

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