

Austria, Myrna S.

Working Paper

The Emerging Philippine Investment Environment

PIDS Discussion Paper Series, No. 1998-27

Provided in Cooperation with:

Philippine Institute for Development Studies (PIDS), Philippines

Suggested Citation: Austria, Myrna S. (1998) : The Emerging Philippine Investment Environment, PIDS Discussion Paper Series, No. 1998-27, Philippine Institute for Development Studies (PIDS), Makati City

This Version is available at:

<https://hdl.handle.net/10419/187369>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

The Emerging Philippine Investment Environment

Myrna S. Austria

DISCUSSION PAPER SERIES NO. 98-27

The *PIDS Discussion Paper Series* constitutes studies that are preliminary and subject to further revisions. They are being circulated in a limited number of copies only for purposes of soliciting comments and suggestions for further refinements. The studies under the *Series* are unedited and unreviewed.

The views and opinions expressed are those of the author(s) and do not necessarily reflect those of the Institute.

Not for quotation without permission from the author(s) and the Institute.



July 1998

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
Or visit our website at <http://www.pids.gov.ph>

THE EMERGING PHILIPPINE INVESTMENT ENVIRONMENT*

Myrna S. Austria¹

Just as the country's trade regime underwent significant reforms during the last decade, so has the investment regime. The Government has sought greater foreign investment by expanding the areas and industries open to foreign investors. A new set of investment incentives for qualified enterprises was also passed in 1987.

The change in the country's investment policies has been a crucial factor in building up confidence in the economic prospects of the country. Despite the reforms, however, the country's performance in attracting foreign investment is still below its neighbors in the region. Likewise, some aspects of the investment incentive system seem to run counter with the objectives of trade reforms and to have some quite perverse effects.

This paper examines trends in foreign direct investment in the country and the effectiveness of the Philippine investment incentive system. Maintaining strong inflows of foreign direct investment and an efficient pattern of overall investment will be vital if the Philippines is to sustain the improved economic performance that it has achieved in the mid to late 1990s.

FOREIGN DIRECT INVESTMENT

Foreign investment regime. Prior to the passing of Republic Act (RA) No. 7042, known as the *Foreign Investment Act (FIA) of 1991*, eligibility for 100 percent foreign equity was subject to the approval of the Board of Investment. However, the FIA of 1991 allowed foreign equity participation of up to 100 percent in all areas, except those specified in the Foreign Investment Negative List (FINL). In 1996, further legislation was passed allowing greater foreign participation in previously prohibited sectors. This, in effect, shortened the foreign investment negative list.

Restrictions on foreign direct investment are now limited to only two areas: (See Appendix A for details).

- *Negative List A* - includes those areas reserved for Filipino nationals by virtue of the Constitution or specific legislation, like mass media, cooperatives or small scale mining.

* An earlier version of the paper which has a special focus on Australia's investment in the Philippines was part of the study *The Philippines Beyond the Crisis* (1998) published by the East Asia Analytical Unit of the Department of Foreign Affairs and Trade of Australia.

¹ Research Fellow, Philippine Institute for Development Studies. The research assistance provided by Euben Paracuelles is gratefully acknowledged.

- *Negative List B* - includes areas by virtue of defense, risk to health and moral, and protection of local small and medium scale industries. Examples of these investment areas are manufacture of firearms and gunpowder, and sauna and steam bathhouses.

All foreign investors are entitled to the basic rights provided in the constitution such as remittance of earnings, freedom from expropriation and requisition of investment, and full and immediate repatriation of capital and remittance of dividends without approval by the Bangko Sentral ng Pilipinas (BSP), provided the foreign investment has been registered with the BSP.

The country's policies on foreign direct investment (FDI) are also generally consistent with the *APEC non-binding investment principles* as agreed upon by the APEC member economies in November 1994 in Indonesia. These principles include:

- transparency
- non-discrimination between source of economies
- national treatment
- investment incentives
- performance requirements
- expropriation and compensation
- repatriation and convertibility
- settlement of disputes
- entry and sojourn of personnel
- avoidance of double taxation
- investor behavior
- removal of barriers to capital exports

The current restrictions on FDI in the Philippines are still consistent with the APEC principle of national treatment as the latter provides for exceptions in areas identified as restricted by the domestic laws of APEC member economies.

TRENDS IN FOREIGN DIRECT INVESTMENT

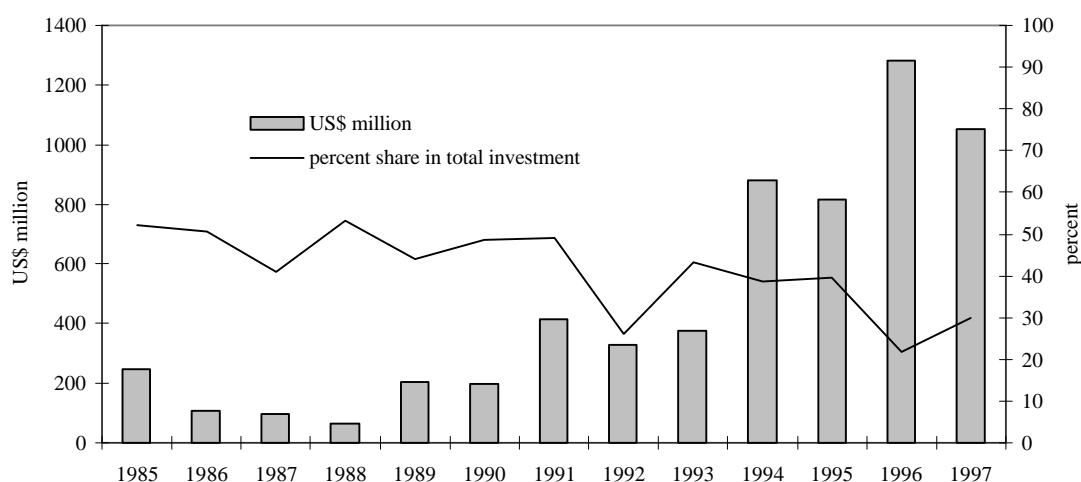
Total FDI. There was little growth in foreign direct investment in the second half of the 1980s, but investment took off after 1990 (Figure 1). The value of foreign direct investment increased from US\$196 million in 1990 to US\$1.1 billion in 1997. In real terms, foreign direct investment grew at an average growth rate of 20 percent a year during the period 1990-1997.

Nonetheless, with domestic investment also growing strongly, the share of foreign investment in total investment has actually fallen from an average of 48 percent per year during the period 1985-1990 to 37 percent per year during the period 1990-1997.

Sectoral allocation. FDI in the Philippines is highly concentrated in manufacturing, which received 47 percent of total foreign direct investment during the

period 1990-1997 (Table 1). FDI in the sector also registered a positive average annual real growth rate in the 1990s compared to the negative growth registered in the second half of the 1980s.

Figure 1
Foreign direct investment, 1985-1997 (US\$ million)



Source: Bangko Sentral ng Pilipinas.

Table 1
FDI by sector, 1985-1997

	Average annual values (US\$ million)		Average annual share (%)		Average annual real growth rate (%)	
	1985-1990	1990-97	1985-90	1990-97	1985-90	1990-97
Banks and Other						
Financial Institutions	15.6	125.5	10.2	18.8	8.9	29.4
Manufacturing	75.9	314.4	49.8	47.0	-7.3	0.6
Mining	37.7	20.4	24.7	3.1	-15.3	-32.8
Commerce	10.5	41.8	6.9	6.3	38.2	14.7
Services	7.1	34.9	4.7	5.2	-19.0	23.8
Public Utility	1.5	93.0	1.0	13.9	-9.0	105.9
Agriculture, Fishery, and Forestry	4.0	1.1	2.6	0.2	-20.0	-45.0
Construction	0.1	37.4	0.1	5.6	-17.3	179.6
Total	152.4	668.5	100.0	100.0	-7.2	19.8

Source: Bangko Sentral Pilipinas.

Within manufacturing, the share of foreign direct investment in machinery, appliances and supplies has increased strongly over the last decade while the share of chemical and chemical products has decreased substantially (Table 2). These changes in shares largely reflect changes in competitiveness as tariff protection has been progressively removed. The stagnant share of foreign direct investment in textiles indicates that this sector remains uncompetitive and incapable of drawing in large amounts of unskilled labor and driving rapid export growth as happened in other East

Asian economies. The large share of petroleum and coal in total FDI in 1993 and 1994 was due to the privatization of the formerly government-owned oil company, *Petron*.

Table 2
Share of selected manufacturing industries in total FDI, 1985-1997
(percent)

Sector	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Chemical and chemical Products	11.1	26.2	19.5	13.7	9.9	8.4	10.8	8.7	9.2	3.6	4.4	4.1	2.4
Food	24.7	0.2	5.4	2.5	3.7	8.0	2.1	6.7	4.7	1.4	1.3	1.5	1.3
Textiles	1.2	1.6	2.0	5.8	4.1	4.8	3.5	5.1	1.7	0.5	1.5	0.2	0.2
Transport equipment	9.6	Na	3.6	0.0	2.7	3.8	5.2	12.2	3.6	0.6	6.5	2.8	2.2
Petroleum and coal	0.9	2.1	1.1	0.0	0.0	0.0	3.0	0.0	34.2	63.7	5.4	0.0	0.0
Metal & metal products	0.1	1.4	0.1	0.1	0.4	0.8	3.4	2.2	1.1	0.9	2.9	4.9	1.3
Machinery, apparatus, Appliances & supplies	1.8	1.4	5.3	3.7	23.9	13.1	40.7	16.6	6.8	4.3	16.3	12.3	6.5

Source: Bangko Sentral ng Pilipinas.

Foreign direct investment in public utility and construction experienced a dramatic increase in their growth rates in the 1990s (Table 1) due to the boom in infrastructure investment for reasons that will be discussed in a later section of the paper.

The reforms in the banking industry also resulted to the sharp increase in foreign investment in banks and other financial institutions making the sector the second largest recipient of foreign investment in the 1990s (Table 1).

The mining sector has the next largest share of FDI after manufacturing in the second half of the 1980s. However, the declining growth of FDI in mining worsened in the 1990s and consequently the share of mining in total FDI has fallen relative to the second half of the 1980s (Table 1). These trends have been due to a range of problems within the mining industry. Several mining companies have stopped operations in the more recent past because of the industry's deteriorating price competitiveness in the international market. Some companies have also been closed due to environmental concerns. These developments lessened the attractiveness of the industry to FDI. Reforms in the mining industry are much needed to reverse its deteriorating state.

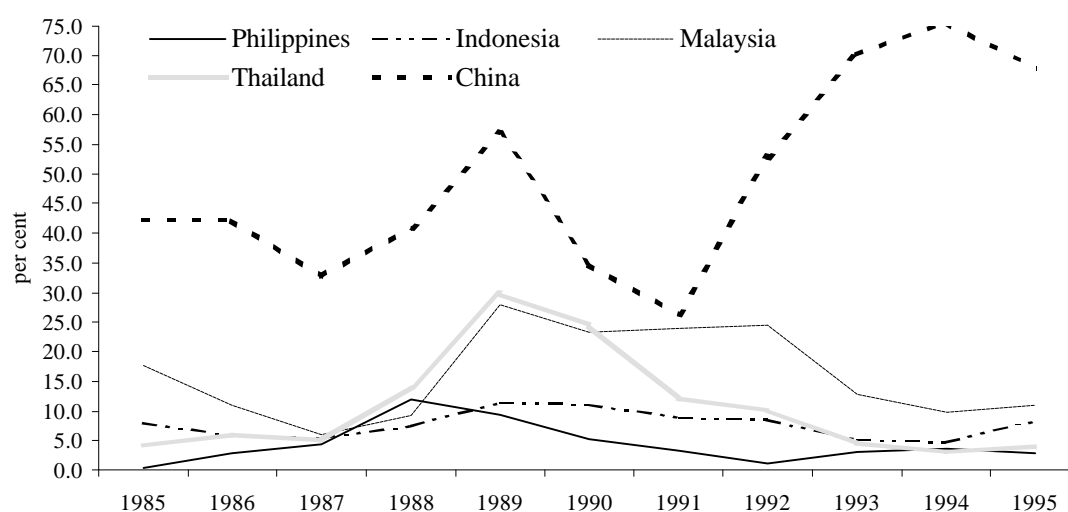
FDI in an ASEAN context. While foreign direct investment in the Philippines has increased in the 1990s, the country continues to receive the smallest share among the ASEAN-Four² in the total FDI in developing member countries (DMCs)³ of the Asian Development Bank (Figure 2). It also has the smallest per capita FDI among the ASEAN-Four (Table 3).

²The ASEAN-Four includes Indonesia, Malaysia, Philippines and Thailand.

³Developing member countries (DMCs) of the Asian Development Bank include those whose per capita GNP in 1995 ranges from less than US\$695 to US\$2,017.

Much of the increase in the share of Thailand, Malaysia and Indonesia in the second half of the 1980s was the result of the rapid growth of Japanese foreign direct investment after the appreciation of the yen following the Plaza Accord of 1985. The Philippines missed out on this growth because of continued political uncertainty, including the Edsa revolution in 1986 and the series of coups during the Aquino administration. Having missed this opportunity, the Philippines has in the 1990s been confronted with much greater competition from China (Figure 2).

Figure 2
Share in total FDI in developing member countries of ADB, 1985-1995
(percent)



Source: Asian Development Bank (ADB) Key Indicators 1997.

Table 3
Per capita FDI, ASEAN-Four, 1985, 1990, 1995 (US\$ million)

Country	1985	1990	1995
Philippines	0.2	8.5	21.0
Indonesia	1.9	6.1	22.3
Malaysia	44.3	131.4	288.6
Thailand	3.2	43.8	34.8
China	1.6	3.1	na

Source: ADB Key Indicators, 1997.

Nonetheless, current trends in other ASEAN economies entail opportunities for the Philippines. In Singapore, Malaysia and Thailand, labor intensive and highly competitive electrical appliances and electronics, food and textiles industries were the largest recipient of foreign direct investment in the late 1980s (Table 4). As wages increased in these countries in the 1990s, there was a shift in FDI orientation to promote higher value added industries or high technology and materials industries, like petroleum and chemical products (Table 4).

Table 4
Investment trends by industry, ASEAN

	Singapore		Indonesia		Thailand		Malaysia		Philippines	
	1987-90	1991-93	1987-90	1991-93	1987-90	1991-93	1987-90	1991-93	1985-90	1990-96
Food/beverage	4.9	2.0	4.2	5.6	7.4	6.5	5.5	2.5	13.9	6.5
Textiles	0.3	0.3	13.8	11.8	6.3	4.1	5.1	6.3	7.2	4.3
Paper & paper products	3.3	2.8	17.5	13.1	na	na	2.4	1.1		
Petroleum	9.9	6.2	na	Na	7.0	9.6	12.1	27.9	2.2	21.4
Chemical products	8.7	21.7	43.0	34.0	13.3	16.9	4.0	13.4	40.0	12.2
Electric & electronic products	45.7	37.4	6.4	21.7	36.7	30.8	28.8	13.7	16.2	28.3
Transport equipment	4.1	6.1			na	na	1.3	1.8	5.8	9.3
Others	23.1	23.5	15.1	13.8	29.3	32.1	40.8	33.3	14.8	18.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Takeuchi, 1995, Table 8; Bangko Sentral ng Pilipinas.

The rise in the cost of labor in these countries caused foreign investors to locate their labor-intensive industries in Indonesia, Philippines (Table 4), China and recently, in Vietnam, India and Bangladesh in the 1990s. If the country can increase its competitiveness in labor intensive industries, such as garments, then there is a strong chance of attracting increased flows of labor intensive FDI capable of contributing to increased rates of gross domestic product by increasing exports. This increase in competitiveness could be achieved through either minimizing wage growth in response to the real depreciation of the peso since the second half of 1997 or through increasing the productivity of unskilled labor.

Sources of FDI. The USA was the dominant source of foreign direct investment in the Philippines in the second half of the 1980s (Table 5). However, the share of the USA has gone down while that of Japan, Hong Kong and South Korea has risen in the 1990s. Moreover, the average annual real growth rate of FDI from Japan and Hong Kong increased significantly while FDI from South Korea and Taiwan slowed in the 1990s. The Netherlands and the United Kingdom also increased their share of total FDI in the 1990s.

The increase in FDI from Japan stems primarily from the rapid appreciation of the yen, the shortage in labor, the surge in wage rates and continued high cost structures which pushed Japanese firms to operate overseas (Urata and Tullao, 1995; East Asia Analytical Unit, 1997). However, the ongoing financial crisis in Japan may slow down Japanese FDI in the next few years.

The rise in the share of Hong Kong was driven by the uncertainty regarding the handover to China. For South Korea, the increase in the share was due to rising domestic labor cost relative to the Philippines.

One factor that caused the decline in the USA's share in the 1990s is the US-Caribbean trade agreements that resulted in diversion of investment from the Philippines (Austria, 1996). This is particularly true in the garments industry where the USA is the Philippines' major export market.

Table 5
FDI by source, 1985-1997

	Average annual value (US\$ million)		Average annual share (%)		Average annual real Growth rate (%)	
	1985-90	1990-97	1985-90	1990-97	1985-90	1990-97
U.S.A.	77.5	95.1	50.9	14.2	-21.6	5.6
Japan	28.4	195.0	18.6	29.2	8.7	22.0
Hongkong	10.4	66.0	6.8	9.9	-14.0	14.5
Netherlands	7.1	87.2	4.7	13.0	-22.2	34.7
U.K.	5.3	43.3	3.5	6.5	5.9	4.3
Australia	3.8	6.6	2.5	1.0	119.9	0.8
South Korea	1.6	15.2	1.0	2.3	97.9	6.6
Taiwan	3.9	12.2	2.6	1.8	85.6	8.0
Other Countries	14.4	147.9	9.4	22.1	15.6	33.2
Total	152.4	668.5	100.0	100.0	-7.2	19.8

Source: Bangko Sentral ng Pilipinas.

Another factor that caused the decline in the share of the USA is the appreciation of the peso. The study by Aldaba (1994:59) has shown that a real depreciation of the peso affects positively the flow of American investments in the country. The same study has shown that this has not been the case for Japanese FDI. Hence, the peso appreciation in the 1990s could well have reduced the relative share of US investment from its level in the 1980s. However, the potential of the country in attracting FDI from the USA after the peso depreciation in 1997 would depend on the extent to which the US-Caribbean trade agreements and the North American Free Trade Area (NAFTA) could divert investment from the Philippines.

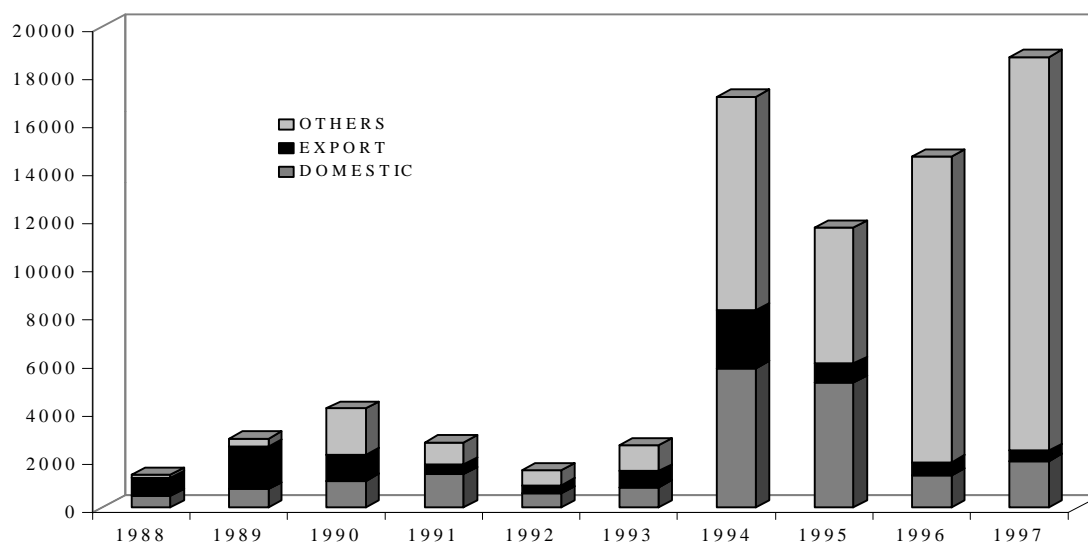
FACTORS AFFECTING FOREIGN DIRECT INVESTMENT

What attracts foreign direct investment? The investment boom in the 1990s is shown by the sharp increase in the total project cost of BOI-approved local and foreign investments (Figure 3) and by the increased ratio of FDI to GDP (Figure 4).

In the 1990s, a number of factors have changed the overall domestic investment climate and increased confidence of foreign investors in the economy. These include:

- *General policy of openness* - tariffs and other barriers to trade were lowered; expansion of areas (particularly services and infrastructure) opened for foreign investment; and foreign exchange deregulation where several restrictions on the flow of foreign exchange were lifted;
- *Strong macroeconomic fundamentals* - inflation rate declined from an average of 16.5 percent in 1991 to 5.1 percent in 1997 because of tight monetary policies; interest rate on Treasury Bills also dropped from an average of 21.5 percent in 1991 to 13.1 percent in 1997;

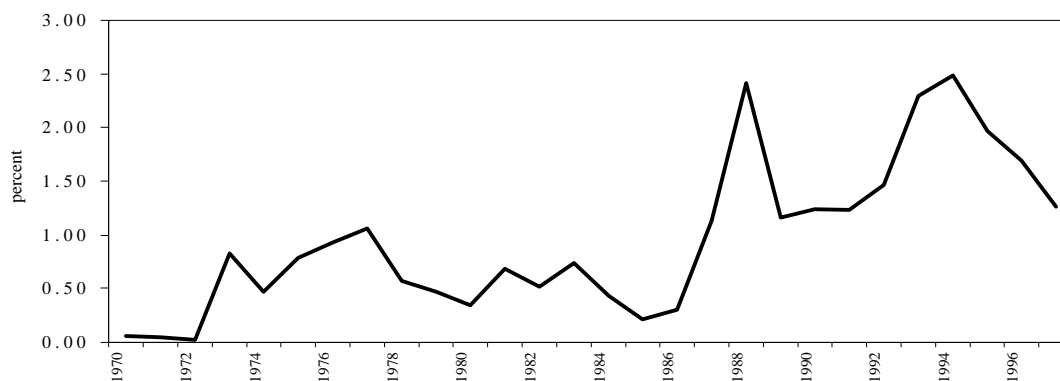
Figure 3
Total project cost of BOI-approved projects, 1988-1997 (US\$ million)



Note: "Others" include energy-related projects, public utilities, infrastructure/industrial services, export traders, service exporters, tourism-oriented projects, environment protection projects, research & development activities, power generators and auxiliary projects.

Source: BOI, DTI.

Figure 4
Ratio of FDI to GDP, 1990-1997 (percent)



Source: Department of Economic Research, Bangko Sentral ng Pilipinas.

- *Economic recovery* since 1993;
- *Political stability* under the Ramos administration;

These factors have in turn made the Philippines' relatively cheap, skilled and English-speaking labor force more attractive.

Tariff protection, which was an important factor in attracting foreign direct investment during previous surges, has not been important in the 1990s. However, there is still a strong foreign presence in industries that were highly protected. This is

especially true for Japanese direct investment which are highly concentrated in manufacturing industries nurtured by high protective walls, such as the transport industry.

The ongoing currency crisis that started in the ASEAN and which has now spread to the rest of East Asia, particularly Japan and South Korea, may change the direction of FDI in the region for the rest of the 1990s. However, the attractiveness of the Philippines as an investment site after the crisis is its ability, as predicted by the international community, to recover at a much quicker rate than Thailand, Malaysia or Indonesia.

What inhibits foreign direct investment? While the Philippines takes pride in its well-educated labor force, the militancy of the labor unions and the inadequate technical and vocational skills of its labor force serve as inhibiting factors to the flow of FDI into the country. Also, the high cost of unskilled labor relative to Indonesia, Vietnam or China lessens the attractiveness of the country as an investment site for labor intensive export oriented industries (Table 6). This problem is compounded by the fact that labor productivity fails to keep pace with wage increases, unlike in the other ASEAN where productivity outstrips wage increases (Takeuchi, 1995). An important factor contributing to this phenomenon is the long time practice of minimum wage setting which is becoming more politicised.

Table 6
Wage Rate, selected countries, 1996

Country	Unskilled Labor (\$/day)	Skilled Labor (\$/day)
Indonesia	2.00-3.00	6.10
Malaysia	7.97	13.28
Philippines	4.00-6.70	7.00-9.17
Taiwan	37.50	51.50
Thailand	5.12-6.13	6.61-7.28
Vietnam	1.29-1.37	2.15-2.38

Source: World Bank, 1997, Table 1.4.

The country is also handicapped by poor infrastructure. As 2000 approaches, by which time tariff protection would have gone down globally, the state of the Philippines' infrastructure will become even more critical in determining the attractiveness of the Philippines as an investment site in the region. What looks promising, however, is the passing of the Build-Operate-and-Transfer Law or Republic Act No.6857 allowing private sector participation in infrastructure and development projects ordinarily undertaken exclusively by the government.

Another negative factor for FDI in the Philippines is the lack of competitive support industries forcing export producers to obtain their intermediate inputs from abroad (Urata and Tullao, 1995; Austria and Medalla, 1996). For example, among the

Japanese firms operating in the ASEAN, the lowest rate of local procurement of parts and components was registered by those operating in the Philippines (Tecson, 1995). The proximity of support of industries with the final goods industries lower production costs and facilitate the production process that can lead to higher productivity. The government should therefore nourish the development and growth of support industries to enhance the country's attractiveness to FDI.

INVESTMENT INCENTIVE SYSTEM

A comprehensive system of incentives exists for both domestic and foreign investment in the Philippines. These incentives, as they are currently designed, are having some important effects on the Philippine economy, including reducing investment in export oriented industries and increasing the capital intensity of the Philippine economy.

Current incentives can be classified into three categories:

- incentives under the 1987 Omnibus Investment Code;
- incentives outside the 1987 investment code; and
- incentives under the export processing zones and special economic zones.

1987 OMNIBUS INVESTMENT CODE

The mainstay of the current investment incentive system is the 1987 Omnibus Investment Code (OIC) administered by the Board of Investment (BOI). An enterprise can apply for incentives under this code if it invests in preferred areas of investment listed in the Investment Priorities Plan (IPP) for a particular year or if it exports at least 70 percent of its production (if majority foreign-owned) or 50 percent (if Filipino-owned). The IPP is the annual list of preferred economic activities encouraged by the government through the granting of fiscal incentives.

1997 Investment Priorities Plan. Only enterprises listed in the Investment Priorities Plan (IPP) are eligible for incentives under the Omnibus Investment Code. The 1997 IPP consists of 32 priority areas and activities classified into five major categories (See Appendix B for details):

- export oriented industries
- catalytic industries such as shipbuilding, food processing, pulp and paper, and cement industries
- industries undergoing adjustment such as textiles, manufacture of both organic and inorganic chemicals, sugar mills, and machinery and equipment
- support activities like manufacture of motor vehicle parts and components, and development of industrial estates and power generation projects
- mandatory inclusions such as exploration of mineral resources, manufacture of steel iron and steel-making and built-operate-transfer projects.

Three major differences can be noted from the current Investment Priorities Plan (IPP) when compared with the 1996 IPP:

- Support to the agricultural sector is reinforced as its activities link up with the manufacturing sector;
- Modernization programs – As indicated in Appendix B, 19 of the priority areas require modernisation to allow them to compete globally via technological upgrading; and,
- Environmental activities are made more focused by more specific listings of environmental projects.

While the Investment Priorities Plan is revised every year, the 1997 priority areas are expected to remain the same at least for the next few years. This is especially true for those listed in the modernization program since upgrading of these industries will take some time. Including modernization projects in the current Investment Priorities Plan is the government's strategy for getting ready for globalization.

Incentives under the 1987 OIC include:

- *Income tax holiday (ITH)* for six years for pioneer⁴ projects and four years for non-pioneer⁵ projects extendible annually for a period not exceeding eight years if the enterprise meets the criteria⁶ set by the Board of Investment relating to capital/labor ratios, use of indigenous materials and net foreign exchange earnings;
- *Tax and duty exemptions* on imported capital equipment and accompanying spare parts;
- *Tax credits* on domestic capital equipment;
- *Additional deduction from taxable income* equivalent to 50 percent of wages of the annual increase in skilled and unskilled workers used as direct labor for a period of five years provided the BOI-prescribed capital/labor ratio is met and this incentive is not utilised simultaneously with the income tax holiday; and
- *Non-fiscal incentives* which include allowing employment of foreign nationals in supervisory, technical or advisory positions for five years;

⁴Pioneer projects are those which (i) engage in the manufacture, processing or production, and not merely in the assembly or packaging of goods, products, commodities or raw materials that have not been or are not being produced in the Philippines on a commercial scale; (ii) use a design, formula, scheme, method, process or system of production or transformation of any element, substance or raw materials into another raw material or finished goods which is new and untried in the Philippines; (iii) engage in the pursuit of agricultural, forestry and mining activities considered as essential to the attainment of national goal; and (iv) produce non-conventional fuels or manufacture equipment which utilises non-conventional sources of energy (BOI, 1997b).

⁵Non-pioneer projects include projects that are engage in common activities in the Philippines and do not make use of new technology (BOI, 1997b).

⁶The capital labour ratio should not exceed US\$10,000 per worker; use of indigenous materials should not be lower than 50 per cent of total raw material costs; and net foreign exchange earnings or savings should be at least US\$500,000 per year for the first three years of operation (BOI, 1997b).

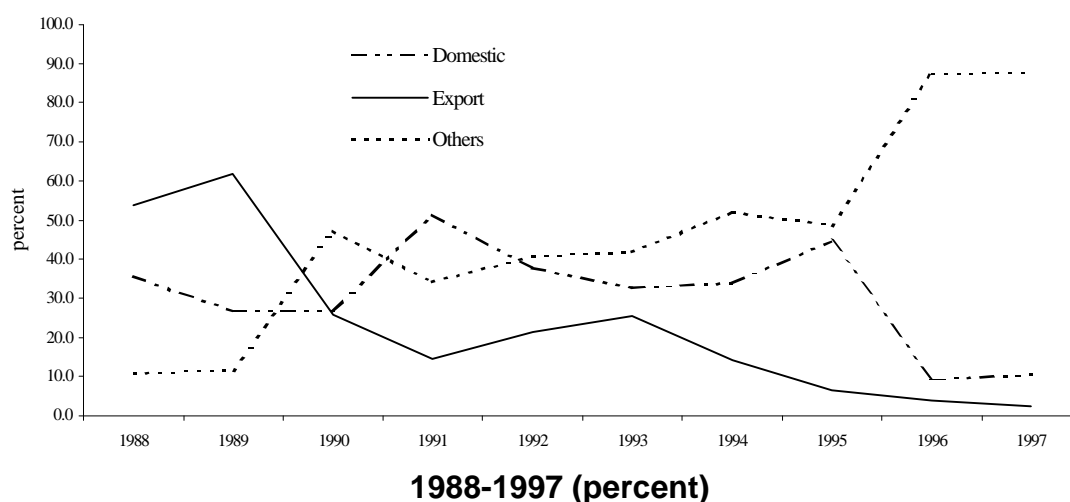
simplifying of customs procedures; and allowing access to bonded manufacturing/trading warehouse.

The above incentives are uniform for exporters and non-exporters. This is in contrast to the previous 1983 code where the incentive system was biased in favor of exporters, primarily to mitigate the bias against exports which existed under the former protectionist regime.

EFFECTS OF THE INCENTIVE SYSTEM

Type of investments. While reforms in the country's trade policies have largely reduced the bias against exports, the current investment incentive system actually favors the domestic oriented industries. The share of export oriented industries in BOI-approved projects is declining and since 1989 has been smaller than the share of domestic oriented industries (Figure 5). This runs counter to the goal of promoting exports and is in marked contrast to the 1983 investment code where export oriented industries accounted for at least 70 percent of the total project cost of BOI-approved projects (Medalla, et. al., 1995). At the aggregate level, a major factor behind the fall in the share of export oriented industries is the surge in infrastructure related projects (captured in the 'other' category in Figure 5), with the share of the purely domestic industries also trending down.

Figure 5
Share in total project cost of BOI-approved projects, by type of producer,



Note: "Others" – as defined in Figure 3
Source: BOI, DTI

The shift in the orientation of BOI-approved projects could be due to two related factors. One is the opening of infrastructure and services to foreign investment; and, two, which reinforced the first, is the real appreciation of the peso prior to the depreciation in July 1997. As Figure 5 shows, the share of export oriented industries in total project cost actually went up from 57 percent in 1988 to 62 percent in 1989 before it started declining in 1990. The real appreciation of the peso, particularly in 1995 and 1996, raised the domestic price of non-tradables relative to tradables and this caused a

general bias in investment toward the non-tradable sector. That this is what happened could be seen from the increasing share of energy-related projects, public utilities and infrastructure/industrial service facilities in total project cost (Figure 5).

The decreasing share of investment in export oriented industries could be an obstacle to growth because of the steady growth of the country's trade deficit. However, if sustained over the next year or two, the peso depreciation is likely to reverse the decline by making investment in traded goods more attractive. Likewise, the many infrastructure support-related projects approved in the 1990s should eventually contribute to greater exports and domestic production.

To the extent that the trade reforms have lessened domestic market distortions, the role of the investment incentive system should be to promote exports on externality grounds⁷. This implies that the target areas and industries for inclusion in the investment priorities plan should be well-studied and well-defined to include only those that are guaranteed to be export winners.

Sectoral allocation. The manufacturing sector accounted for most of the total project cost of both domestic and export oriented BOI-approved projects (Figure 6 and Figure 7). While agriculture and mining are vital sectors for the future growth prospects of the Philippines, their shares in BOI-approved investment remained negligible for the past decade.

However, within the manufacturing sector, the share of export oriented industries in total project cost has fallen (Table 7). Also, the coverage of the incentives for exports is limited to a few industries and varies considerably over time. While the electronics industry, the country's main foreign exchange earner, received the bulk in incentives in 1988, its share fell 8.2 percent in 1997. The share of garments is minimal. The share of export oriented textile was quite high in 1990 because of the modernization program of the industry but in 1997 its share fell to 2.4 percent.

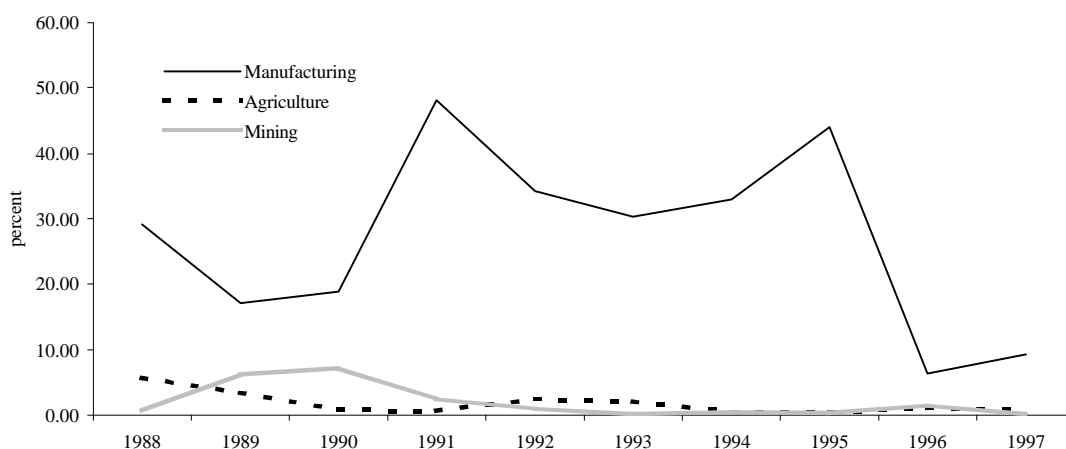
Factor intensity. The investment incentive system has also increased the bias towards capital intensive industries as shown by the rising capital-labor ratio of BOI-approved projects between 1988 and 1995 (Figure 8). This is especially true for the domestic-oriented industries whose capital-labor ratio in real terms rose from US\$17,600 to US\$252,400 between 1988 and 1995, while the capital-labor ratio of export oriented industries increased from US\$4,800 to US\$10,100.

The capital bias of the approved investment is in marked contrast to the incentive system under the 1983 investment code where the capital-labor ratio fell drastically between 1983 and 1986 (Medalla, et. al. 1995). There are two main reasons for the reversal of this trend. Firstly, the incentive of exempting investors from taxes and duties on imported capital equipment and accompanying parts which is likely to encourage capital intensive projects was not included in the 1983 investment code. Secondly, energy-related projects and other infrastructure-related projects which dominated investment approvals in the 1990s tend to be highly capital intensive.

⁷At the enterprise level, exports (i) allow enterprises to achieve economies of scale by taking advantage of market expansion; (ii) enable them to absorb technologies and knowledge through their participation in international markets; and (iii) pressure them to reduce inefficiency and increase productivity to make them internationally competitive.

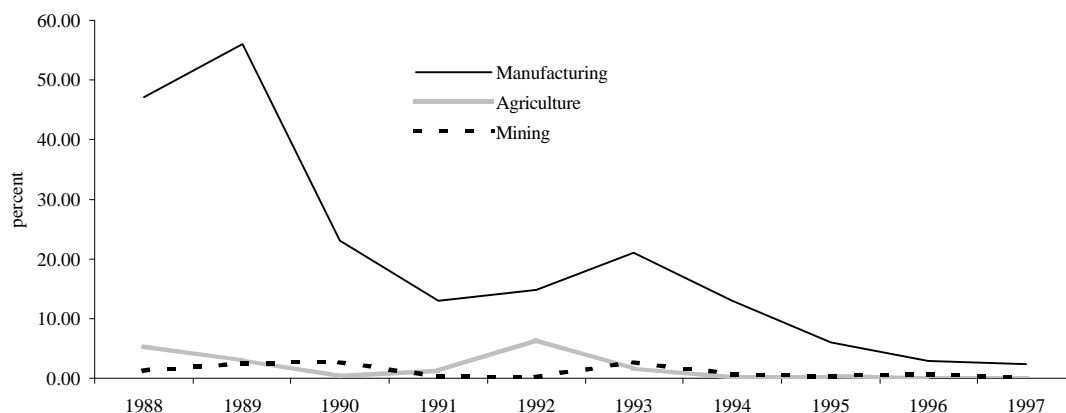
However, in 1996 and 1997, there was a sharp decline in the capital-labor ratio for domestic and export oriented industries with figures of US\$44,000 and US\$6,800 respectively, in 1997. It is necessary that the declining trend be sustained in the coming years to make the incentive system consistent with the goal of promoting labor-intensive industries to help address the problem of high unemployment and underemployment in the country.

Figure 6
Share of domestic producers in total project cost of BOI-approved projects, by sector, 1988-1997 (percent)



Source: BOI, DTI.

Figure 7
Share of export producers in total project cost of BOI-approved projects, by sector, 1988-1997 (percent)



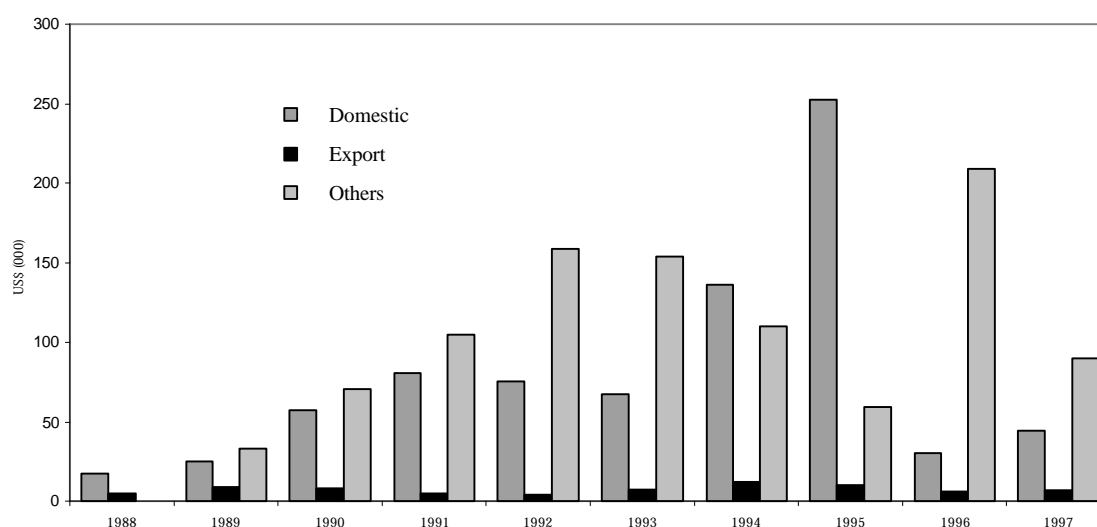
Source: BOI, DTI

Table 7
Percentage share in total BOI-approved project cost, manufacturing,
1988,1990, 1997 (percent)

	1988		1990		1997	
	Domestic	Export	Domestic	Export	Domestic	Export
TOTAL	37.3	62.7	44.4	55.6	80.5	19.5
Processed foods	0.0	2.9	1.9	1.7	2.9	5.0
Textile & textile prods.	1.1	6.7	0.3	16.9	0.0	2.4
Wearing apparel	0.0	3.1	0.0	1.4	0.0	0.2
Basic industrial chemicals	20.0	2.5	3.8	0.5	9.2	0.0
Construction/housing components	10.7	2.0	22.0	1.3	46.8	0.7
Machinery & equipment	0.0	0.8	0.1	1.7	0.2	0.0
Electrical & electronic products	0.5	23.8	0.1	11.7	0.0	8.2
Other products	5.0	20.9	16.2	20.4	21.4	2.9

Source: BOI, DTI

Figure 8
Real Capital/Labor ratio of BOI-approved projects, by type of producer,
1988-1997 (US\$'000)



Note: "Others" - as defined in Figure 3

Source: BOI, DTI.

INCENTIVES OUTSIDE THE 1987 OMNIBUS INVESTMENT CODE

Outside of the 1987 investment code, exporters can apply for duty and tax concessions under the following schemes:

- *Bonded manufacturing warehouse* where exporters are exempt from payment of duties and taxes on their imports;

- *Customs common bonded warehouse*, a modification of the bonded manufacturing warehouse, which allows small and medium scale exporters who cannot afford to operate an individual bonded manufacturing warehouse, to import their intermediate inputs tax and duty-free through the customs common bonded warehouse to which they are accredited;
- *Duty exemption scheme* which allows duty-free importation of raw materials that are to be processed into finished products for exports; and,
- *Duty drawback/tax credit scheme* which allows direct and some indirect⁸ exporters to obtain drawbacks on duties and taxes paid on intermediate goods.

Unfortunately, the above schemes are generally ineffective. The proliferation of agencies⁹ administering them creates confusion and conflict; and the bureaucratic complexities and delays impose significant costs on the exporters (GATT 1993). The coverage of exporters and export products is also limited. Moreover, the operation of bonded manufacturing warehouse requires capital outlays which only large exporters can afford while small exporters find the service fees of customs common bonded warehouse high (GATT 1993).

Nevertheless, the creation of a One-Stop Action Centre for Investment (OSAC) in the late 1980s for the centralised administration and processing of incentives and claims have improved the effectiveness of these incentives (GATT 1993).

INCENTIVES FOR FIRMS IN EXPORT PROCESSING ZONES AND SPECIAL ECONOMIC ZONES

To promote industrialization in regions outside Metro Manila, the government promotes the establishment of industrial estates. These are economic enclaves within which investing firms enjoy freedom from industrial regulations applying elsewhere in the country. There are two types of industrial estates. The first is the regular export processing zones (EPZ), owned and operated by the government, whose production is solely for export. The second is privately owned industrial estates, designated as special economic zones (SEZ), whose production could be either for export or domestic consumption. Both types of zones are administered by the Philippine Economic Zone Authority (PEZA).

Enterprises operating in the zones enjoy an integrated package of incentives, streamlined government procedures and physical infrastructure and facilities which are not available outside the zones. The incentives¹⁰ include:

⁸Indirect exporters are those producing an input to an export product. Examples are textile firms whose products are used by export oriented garment industries.

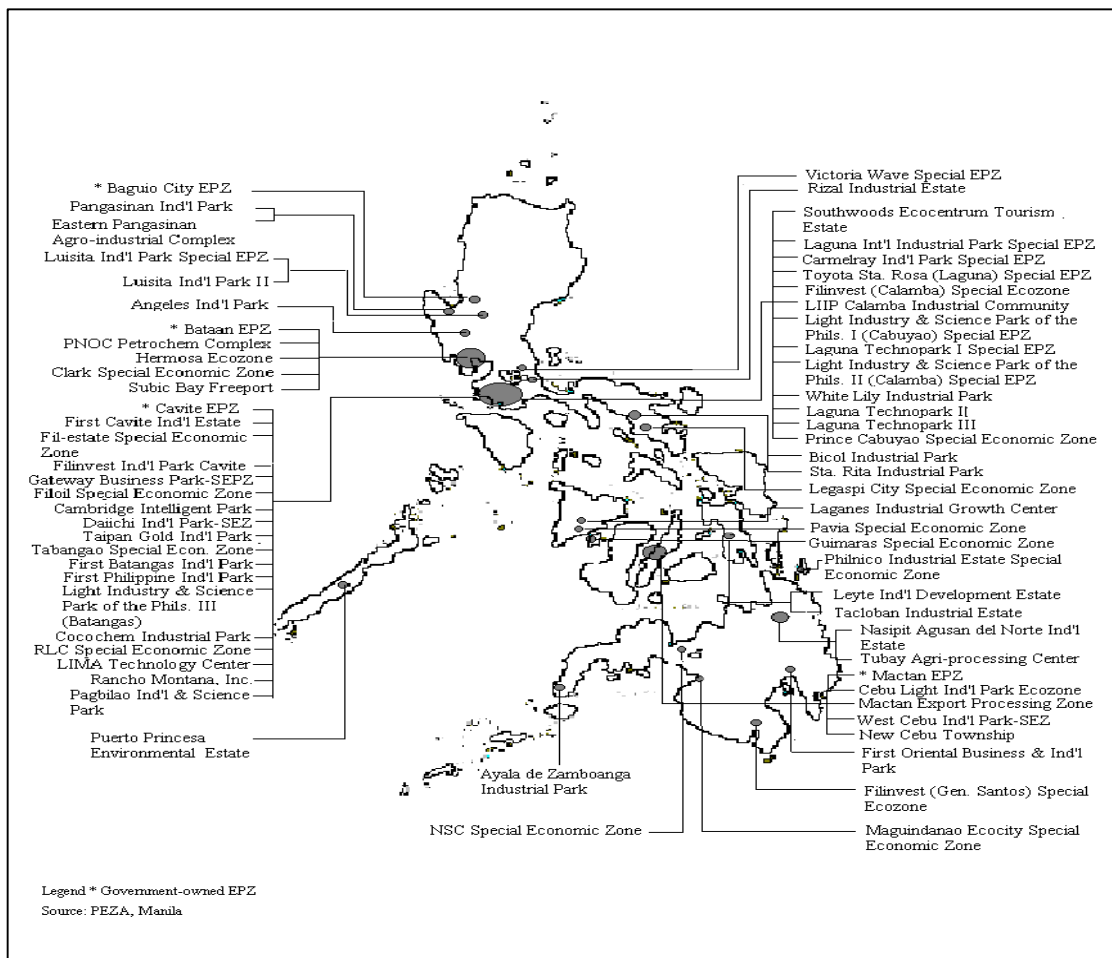
⁹These agencies include the Bureau of Customs, Bureau of Internal Revenue, Department of Trade and Industry and the Bangko Sentral ng Pilipinas.

¹⁰Incentives for firms operating in the regular export processing zones and special economic zones are the same.

- Exemptions from the payment of duties and taxes for capital equipment, raw materials and supplies, local taxes and licenses, except real estate taxes, contractor's taxes, wharfage fees and export tax;
- Tax deductibility of labor training expenses, organisational and pre-operating expenses;
- Tax credits on supplies and materials and domestic capital equipment;
- Income tax holiday of 6 years for pioneer firms; 4 years for non-pioneer firms; and 3 years for expansion¹¹ firms;
- After the income tax holiday, a special 5 percent tax on gross income, in lieu of all national and local taxes; and
- Other incentives available under the 1987 OIC, as determined by the PEZA Board.

By June 1997, there are 4 regular export processing zones and 63 special economic zones located in strategic regions/provinces all over the country (Figure 9). The most notable among these zones are the Subic Free Port (Box 1), Clark Special Economic Zone (Box 2) and the Cavite-Laguna-Batangas-Rizal-Quezon growth area or simply, CALABARZON (Box 3).

Figure 9
The PEZA Economic Zones (as of June 1997)



¹¹Expansion firms include those which are expanding their current product lines but have to locate within 50 kilometers radius from their existing plants.

Box 1

Subic Bay: Freeport of the Future

The Subic Bay Freeport (SBF), located in Olongapo City in Central Luzon, was previously a naval operations center for the U.S. navy. After the U.S. withdrawal in 1992, Subic was converted into a self-sustaining, industrial, commercial, financial, investment, tourism and leisure center. It started full commercial and industrial operations under Filipino management in 1993. The 7,000-hectare ecozone is now about 95 per cent occupied. Among the biggest investors include Taiwanese computer maker Acer, the Malaysian-controlled Subic Bay Resort and Casino, Filipino/Australian marina developer Subic Bay Waterfront Development Corporation, American firm Federal Express, Coastal Subic Bay Terminal and Enron Subic Power Corporation.

It is also the location of the *Subic Bay Industrial Park* that houses some 50 Taiwanese firms, and the *Japanese Technopark* that houses 50 Japanese medium-sized firms involved in support industries for giant technology firms, telecommunications equipment assembly, wire and circuit board manufacturing and automotive sectors. Another Taiwanese industrial estate is being developed.

Subic's attractions and advantages

- \$8 billion worth of infrastructure left by the US Navy and now available for business purposes.
- Safe and secure strategic location; only 1.5 hours by plane from Taiwan and Hong Kong; 3.5 hours from Singapore and Brunei; 4 hours from Japan, Indonesia and Malaysia; and 0.3 hours from Manila.
- Highly efficient security
- State-of-the art telecommunications and airport
- Abundant water and power supply
- Excellent shipping support and facilities
- Freeport status
- Attractive environment
- Ample housing for foreign executives

Target industries

Financial services; recreational activities; tourism investments; mass media industry; information services; transport-related industry; warehousing and distribution; light manufacturing and assembly; and support industry

Performance

- Total number of projects approved as of May 1997 – 265, of which 193 are operational and 72 non-operational
- Total project cost of approved projects as of May 1997 - US\$2 billion.
- Exports for the period January-August 1997 - US\$349.74 million, an increase of 64.8 per cent from the same period in 1996.

Source: Department of Trade and Industry.

Box 2

Clark Special Economic Zone The Launching Pad of Philippine Economic Ambitions

Formerly called *Clark Air Base*, this US military base was converted into a special economic zone after the withdrawal of the Americans in 1992. It is located in Angeles, Pampanga in Central Luzon. The zone is divided into two areas: the 4,400 hectare Main Zone which comprises the former Clark Air Base proper, and the Sub-zone which comprises some portions of the reverted baselands with a total area of 23,601 hectares.

The *Main Zone* is being developed as the site of modern industrial estates, tourism and trade attractions, and the Philippines' future premier international airport. The *Sub-zone*, on the other hand, has been earmarked for agricultural projects, corporate farming, contract farming and agro-industries.

Clark's attractions and advantages

- Strategic location - by flying time, it is only 1.5 hours from Hong Kong, 2 hours from Taiwan and four hours from Singapore, Japan and South Korea
- Availability of existing facilities and land for long term leasing
- Availability of skilled English-speaking workers
- Liberal incentive package
- Location of the future premier international airport of the country
- Infrastructure set-up carried over from the Americans - telecommunication facilities, power, water and sewerage system, fuel/petroleum, oil and lubricants depot, housing and educational facilities.

Target Industries

Main zone: Light industries such as electronics, semiconductor, microchip, & computer-related industries; export-oriented, high-employment industries; airport-related industries; tourism projects; development applications.

Sub-zone: Agriculture products; industrial estates for light and medium industries; tourism projects; ecological/environmental projects.

Performance

- From 1993 to November 1997, committed investments for industrial projects alone amounted to US\$159 million.
- As of November 30, 1997, 222 firms have located in Clark – 137 are lease agreements, 72 are sub-lease agreements, and 13 are joint ventures.
- From 1993 to November 1997, total employment was 23,359 and is expected to climb up to 69,405 within the next 5 years.

Source: Department of Trade and Industry

Box 3
CALABARZON
Gateway to the Asia-Pacific Region

CALABARZON, short for Cavite-Laguna-Batangas-Rizal-Quezon, located south of Metro Manila, has gained the reputation of being the most progressive and dynamic regional growth area in the country. To accommodate foreign investments and enterprises, there are 13 world-class industrial estates fully equipped with industrial and commercial support facilities. The most notable are Laguna Technopark, Light Industry and Science Park, Carmelray Industrial Park, Gateway Business Park, Laguna International Industrial Park, First Cavite Industrial Park and the well-established Cavite Export Processing Zone.

CALABARZON's advantages and attractions

- State-of-the-art telecommunication facilities
- 1 major international port in Batangas; 2 commercial ports in Quezon and 64 fishing ports lying within 150 km south of Manila
- Abundant water and power supply
- Land lease loan extended from 50 to 75 years
- Fiscal incentives
- Low crime rate with strategically located military detachments
- Support industries outside the zone

Investment priority areas

Electric/electronic products, metal furniture, chemicals, machinery and components, construction materials, shipbuilding, consumer durables, fresh and processed fruits and food products, metal manufactures, garments, computer software, wood furniture, cutflowers and ornamental plants, textile, footwear and leather goods.

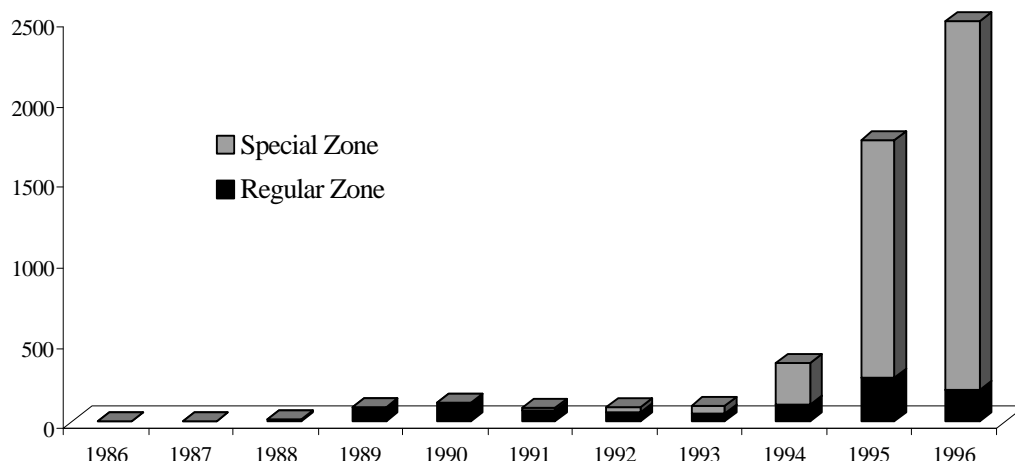
Performance

- Total number of projects from 1986 to the first semester of 1997 was 1352.
- For the first semester of 1997, 41 projects were approved with a combined total project cost of US\$2.5 billion.
- Total project cost from 1986 to June 1997 amounted to US\$12.1 billion.
- Employment generated for the first semester of 1997 was 46,339 - more than double the 17,541-employment level for the whole year of 1996.
- Total employment from 1986 to June 1997 was 275,162 workers.

Source: Department of Trade and Industry, Region IV.

The zones played an important role in promoting exports and investment in the Philippines in recent years. The number of registered firms operating in the zones increased from 57 in 1986 to 151 and 553 in 1990 and 1996, respectively. The total value of investments in the zones registered a dramatic increase during the period 1994-1996 (Figure 10). The special economic zones, in particular, are increasingly becoming attractive sites for investment with their share in total investment in the zones increasing from 17 percent in 1991 to 92 percent in 1996. Electrical machinery (which includes electronics) was the largest recipient of investment in the zones during the period 1992-1996 (Table 8).

Figure 10
Total investment in economic zones, 1986-1996 (US\$ million)



Source: PEZA.

Table 8
Distribution of investments at the economic zones, by industry, 1992-1996 (percent)

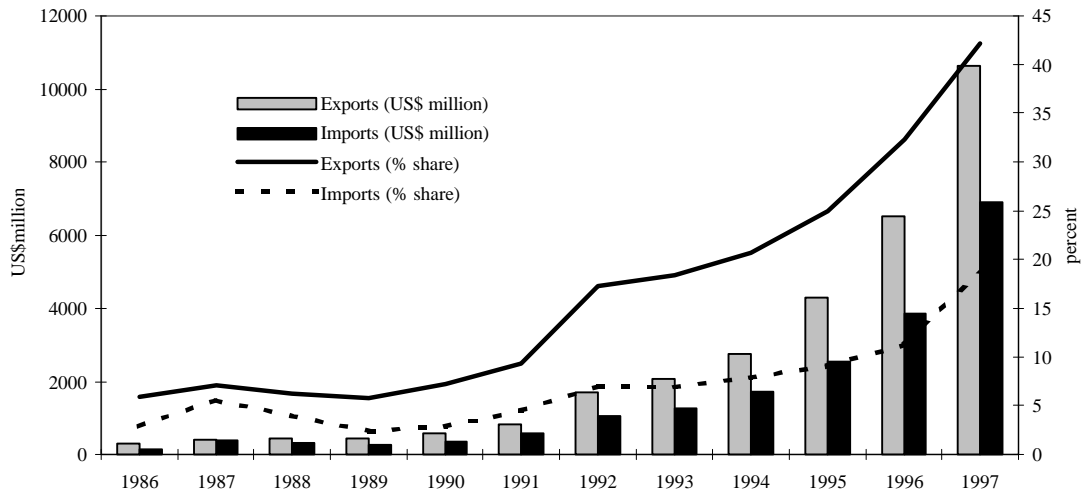
Industry	1992-1996
Textiles	5.1
Wearing apparel	5.9
Wood and furniture	2.6
Industrial chemicals and chemical Products	1.6
Rubber & plastics	9.0
Metal & non-metal products	7.5
Electrical machinery	47.2
Transport equipment	9.4
Others	11.8
Total	100.0

Source: Philippine Economic Zone Authority (PEZA).

Exports originating from the zones also rose from US\$278.1 million in 1986 to US\$10.6 billion in 1997 (Figure 11). These exports represented 6 percent and 42 percent of Philippine total exports in 1986 and 1997, respectively. Imports to the zones increased from US\$148.1 million in 1986 to US\$6.9 billion in 1997 or 3 percent and 19 percent of Philippine total imports, respectively. With exports growing much faster than imports, the net trade balance in the zones has always been positive (Figure 12).

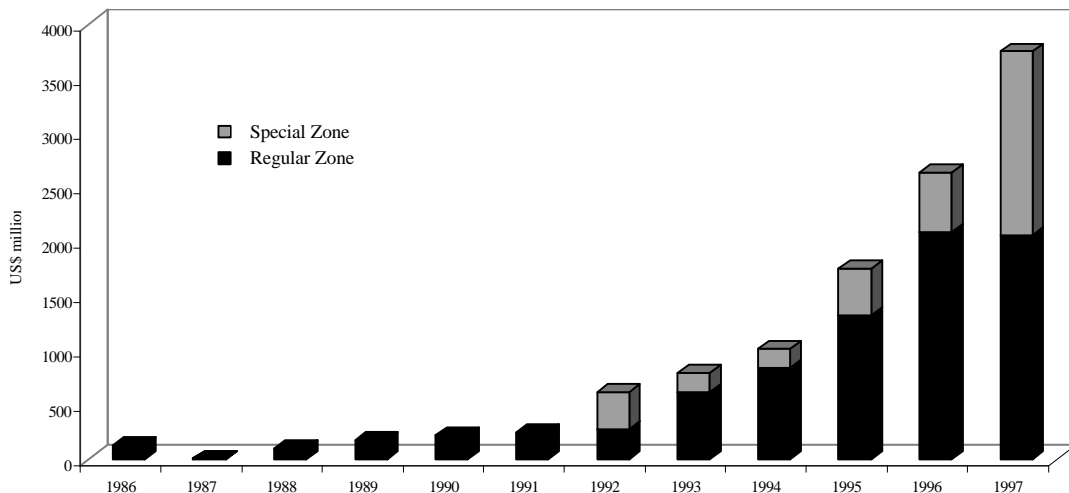
Jobs generated from the zones also increased from 23,750 in 1986 to 152,250 in 1996. However, this has remained at less than 1 percent of total employment in the country.

Figure 11
Exports and imports in economic zones, 1986-1997



Source: PEZA.

Figure 12
Net trade balance, economic zones, 1986-1997 (US\$ million)



Source: PEZA.

In general, the net economic impact of the economic zones in the Philippines is positive (World Bank, 1997). This is primarily due to the increased involvement of the private sector in the development and administration of zones; and hence, lowered government expenditures on the zones. Nevertheless, the recent trend in the zones' performance is becoming an issue of concern. These issues include (World Bank, 1997):

- *Large percentage of investment going to zone infrastructure development* - In 1996, around 66 percent of total investment in the zones were made by zone developers. This could result to an oversupply of space in the next few years if it is not accompanied by a rapid increase in the number of new enterprises that will locate in the zones.

- *Growing concentration of investment in electronics industry* - About 47 percent of total investment in 1992-1996 went to electrical machinery, mostly semiconductors (Table 8). This trend could make the zones vulnerable to a downturn in the semiconductor industry. The local activity in the industry is limited with the simplest assembly and testing level. Unless the local industry improved on its capability (in terms of technological skills and facilities) to absorb and cope with new and advanced technologies, the long-term competitiveness of the industry will be at risk and the country will lose its attractiveness as a supplier base for high technology products.
- *Lack of backward linkages with the rest of the economy* - Enterprises in the zones are heavily import dependent. The expected role of the zones of integrating the domestic economy into the global market is yet to be realised. Net foreign exchange earnings of the zones, for example, are only around 25-30 percent of gross exports.

Nevertheless, if the above issues are properly addressed by the government with the right policies, the ecozone program will continue to be an important integral part of the Philippines' strategy of strengthening its competitiveness in the international market.

OUTLOOK

What direction will investments in the country take for the rest of the 1990s and the next millennium in the midst of the changing domestic and international environments? The Philippines' impressive investment performance during the past few years can be sustained so long as the government can keep up with its investor-friendly policies. As the Philippines' experience in the 1990s shows, its attractiveness will no longer be based on a highly protected domestic market but on a combination of several factors which together foster efficiency, productivity and competitiveness in the international market. The government will have to guard against policy reversal in the areas of trade and investment liberalization and deregulation, especially at a time when the ongoing currency turmoil in the region is making its impact on domestic industries and wage earners.

A major reform in the incentive program is the need to design a universal set of incentives and investment policies to be applied inside and outside the zones. This reform would encourage firms to locate in areas based on their true merits, such as infrastructure availability and presence of suppliers and customers, rather than available fiscal incentives.

APPENDIX A

FOREIGN INVESTMENT NEGATIVE LIST (Pursuant to EO No.362, Effective 24 October 1996)

LIST A. FOREIGN OWNERSHIP IS LIMITED BY MANDATE OF THE CONSTITUTION AND SPECIFIC LAWS

No foreign Equity

1. Mass media except recording (Article XVI, Section 11 of the Constitution; Presidential Memorandum dated 04 May 1994)
2. Services involving the practice of licensed professionals save in cases prescribed by law.
 - a.) Engineering
 - i. Aeronautical Engineering
 - ii. Agricultural Engineering
 - iii. Chemical Engineering
 - iv. Civil Engineering
 - v. Electrical Engineering
 - vi. Electronics and Communications Engineering
 - vii. Geodetic Engineering
 - viii. Mechanical Engineering
 - ix. Metallurgical Engineering
 - x. Mining Engineering
 - xi. Naval Architecture and Marine Engineering
 - xii. Sanitary Engineering
 - b.) Medicine and Allied Professions
 - i. Dentistry
 - ii. Medical Technology
 - iii. Midwifery
 - iv. Nursing
 - v. Nutrition and Dietetics
 - vi. Optometry
 - vii. Pharmacy
 - viii. Physical and Occupational Therapy
 - ix. Radiologic and X-ray Technology
 - x. Veterinary Medicine
 - c.) Accountancy
 - d.) Architecture
 - e.) Criminology
 - f.) Chemistry
 - g.) Customs Brokerage
 - h.) Environmental Planning
 - i.) Forestry
 - j.) Geology
 - k.) Interior Design
 - l.) Landscape Architecture
 - m.) Law
 - n.) Librarianship
 - o.) Marine Deck Officers
 - p.) Marine Engine Officers
 - q.) Master Plumbing
 - r.) Sugar Technology
 - s.) Social Work
 - t.) Teaching

(Article XII, Section 14 of the Constitution; Section 1 of RA No. 5181)

3. Retail Trade (Republic Act No. 1180)
4. Co-operatives (Chapter III, Article 26 of RA No. 6938)
5. Private Security Agencies (Section 4 of RA No. 5487)
6. Small-scale Mining (Section 3 of RA No. 7076)
7. Utilisation of Marine Resource in archipelagic waters, territorial sea, and exclusive economic zone (Article XII, Section 2 of the Constitution)
8. Ownership, operation and management of cockpits (Section 5 of Presidential Decree No. 449)
9. Manufacture, repair, stockpiling and/or distribution of nuclear weapons (Article II, Section 8 of the Constitution)¹²
10. Manufacture, repair stockpiling and/or distribution of biological, chemical and radiological weapons (Various treaties to which the Philippines is a signatory and conventions supported by the Philippines)¹

Up to Twenty - Five Per cent (25%) Foreign Equity

11. Private recruitment, whether for local or overseas employment (Article 27 of Presidential Decree No. 442)
12. Contracts for the construction and repair of locally-funded public works except:
 - a. infrastructure/development projects covered in RA No. 7718; and
 - b. projects which are foreign funded or assisted and required to undergo international competitive bidding (Commonwealth Act No. 541; Presidential Decree 1594; Letter of Instruction 630; Section 2a of RA No. 7718)

Up to Thirty Per cent (30%) Foreign Equity

13. Advertising (Article XVI, Section 2 of the Constitution)

Up to Forty Per cent (40%) Foreign Equity

14. Exploration, development, and utilisation of natural resources (Article XII, Section 2 of the Constitution)²
15. Ownership of private lands (Article XII, Section 7 of the Constitution; Chapter 5, Section 22 of Commonwealth Act No. 141)
16. Operation and management of public utilities (Article XII, Section 11 of the Constitution; Section 16 of Commonwealth Act No. 146)
17. Ownership/establishment and administration of educational institutions (Article XIV, Section 2 of the Constitution)

¹² Domestic investments are also prohibited (Article II, Section 8 of the Constitution; Conventions/Treaties to which the Philippines is a signatory).

² Full foreign participation is allowed through financial or technical assistance agreement with the President (Article XII, Section 11 of the Constitution)

18. Engaging in the rice and corn industry (President Decree No. 194)
19. Financing companies regulated by the Securities and Exchange Commission (SEC) (Section 6 of RA No. 5980)
20. Contracts for the supply of materials, goods and commodities to government-owned and controlled corporation, company, agency or municipal corporation (Section 1 of RA No. 5183)
21. Contracts for the construction of defense-related structures (e.g. land, air, sea and coastal defenses, arsenals barracks, depots, hangars, landing fields, quarters and hospitals) (Commonwealth Act No. 541)
22. Project proponent and facility operator of a BOT project requiring a public utilities franchise (Article XII, Section 11 of the Constitution; Section 2a or RA No. 7718)
23. Private domestic construction contracts (Republic Act 4566; Article XIV, Section 14 of the Constitution)

LIST B. FOREIGN OWNERSHIP IS LIMITED FOR REASONS OF SECURITY, DEFENSE, RISK TO HEALTH AND MORALS AND PROTECTION OF LOCAL SMALL AND MEDIUM-SCALE ENTERPRISES

Up to Forty Per cent (40%) Foreign Equity

1. Manufacture, repair, storage and/or distribution used in the manufacture thereof requiring Philippine National Police (PNP) clearance:
 - a. Firearms (handguns to shotguns), parts of firearms and ammunition therefore, instruments or implements used or intended to be used in the manufacture of firearms
 - b. Gunpowder
 - c. Dynamite
 - d. Blasting supplies
 - e. Ingredients used in making explosives:
 - i. Chlorates of potassium and sodium
 - ii. Nitrates of ammonium, potassium, sodium, barium, copper (11), lead (11) calcium and cuprite
 - iii. Nitric acid
 - iv. Nitrocellulose
 - v. Perchlorates of ammonium, potassium and sodium
 - vi. Dinitrocellulose
 - vii. Glycerol
 - viii. Amorphous phosphorus
 - ix. Hydrogen peroxide
 - x. Strontium nitrate powder
 - xi. Toluene
 - f. Telescopic sights, sniperscope and other similar devices (RA No. 7042 as amended by RA 8179)
2. Manufacture, repair, storage and/or distribution of products requiring Department of National Defense (DND) clearance:
 - a. Guns and ammunition for warfare
 - b. Military ordinance and parts thereof (e.g., torpedoes, mines, depthcharges, bombs, grenades, missiles)
 - c. Gunnery, bombing and fire control systems and components

- d. Guided missiles/missile systems and components
 - e. Tactical aircraft (fixed and rotary winged), parts and components thereof
 - f. Space vehicles and components systems
 - g. Combat vessels (air, land and naval) and auxiliaries
 - h. Weapons repair and maintenance equipment
 - i. Military communications equipment
 - j. Night vision equipment
 - k. Stimulated coherent radiation devices, components and accessories
 - l. Armament training devices
(RA No. 7042 as amended by RA No. 8179)
- 3. Manufacture and distribution of dangerous drugs (RA No. 7042 as amended by RA No. 8179)
 - 4. Sauna and steam bathhouses, massage clinics and other like activities regulated by law because of risks they may impose to public health and morals (RA No. 7042 as amended by RA 8179)
 - 5. Other forms of gambling, e.g., race track operation; (RA No. 8179 as amended by RA No 8179)
 - 6. Domestic market enterprises with paid-in equity capital of less than the equivalent of US\$200,000 (RA No. 7042 as amended by RA No. 8179)
 - 7. Domestic market enterprises which involved advanced technology or employ at least fifty (50) direct employees with minimum paid-in capital of US\$100,000 (RA No. 7042 as amended by RA No. 8179)

APPENDIX B

Priority Investment Areas

List of priority areas/activities	Coverage/Definition
I. Export-oriented Industries (P/NP)*	<ol style="list-style-type: none"> 1. Export producer Manufacturers of non-traditional export products/services with capability to export at least 50% of its output, if Filipino -owned and at least 70% if foreign-owned. 2. Export trader 3. Service exporter 4. Agri-processing estates 5. Activities in support to exporters
II. Catalytic Industries A. Manufacturing	
<ol style="list-style-type: none"> 1. Composite Board (P/NP) 	Manufacture of composite boards using as raw materials the following: natural resource-based materials and industrial wastes.
<ol style="list-style-type: none"> 2. Drugs and Medicines (P/NP) 	<ol style="list-style-type: none"> 1. Manufacture of bulk chemicals, including those derived from indigenous plants. 2. Formulation or preparation of bulk chemicals into dosage form for catastrophic diseases, animal vaccines, and biologics for animal diseases.
<ol style="list-style-type: none"> 3. Shipbuilding/ ship repair/ shipbreaking (P/NP) 	<ol style="list-style-type: none"> 1. Construction of cargo/ passenger vessels 2. Repair of cargo/ passenger vessels 3. Breaking of cargo/ passenger vessels <p>Steel re-rolling and/ or steel scrap supply agreement with local millers must be submitted to support the application for shipbreaking.</p>
<ol style="list-style-type: none"> 4. Processed foods (P/NP)* 	<ol style="list-style-type: none"> 1. Processed fruits and vegetables(except those that are identified as export winners) 2. Seafoods (except shrimps and tuna) 3. Meat (Western style such as ham, salami, bacon, bologna, etc.) 4. Cocoa products 5. Confectionery 6. Cereal and cereal preparations <p>Cocoa and cocoa preparations, confectionery, cereal and cereal preparations may only be registered if they will adopt “state-of-the-art” and/or cost-effective technology.</p>
<ol style="list-style-type: none"> 5. Cement (P) 	<p>Limited to NEW projects only. Cement projects with at least 1.0 million Metric Tons Per Year (MTPY) capacity (clinker base) may qualify for registration on pioneer status but Income Tax Holiday (ITH) is limited to four (4) years and not entitled to bonus years.</p>
B. Agriculture, Food and Forestry	
<ol style="list-style-type: none"> 1. Production of planting materials, breeders, genetic materials & fingerlings (P/NP). 	<ol style="list-style-type: none"> 1. Commercial production of quality / certified seeds and/or seedlings; 2. Breeder stocks of livestock and poultry or its genetic materials; and 3. Fingerlings of fish and crustaceans <p>New and expansion projects may qualify for pioneer status if they are endorsed by the Department of Agriculture (DA) as highly essential to the attainment of the national goals of food security and global competitiveness</p>

2. Pulp and paper (P/NP)*	<p>Modernisation activity for the manufacture of products such as newsprint, printing and writing, packaging, and specialty paper.</p> <p>New and expansion projects using pulp-based materials other than waste paper, may be registered on pioneer status.</p>
<p>III. Industries Undergoing Industrial Adjustment</p>	
A. Textiles (P/NP)*	<ol style="list-style-type: none"> 1. Spinning 2. Weaving 3. Knitting; and 4. Dyeing and finishing <p>Only pioneer new and expansion projects may be registered. Specialised mills with project cost of at least P1.0B may qualify for pioneer status.</p>
B. Chemical products (P/NP)*	<ol style="list-style-type: none"> 1. Manufacture of both organic and inorganic chemicals. 2. Manufacture of petroleum products form refining of crude oil with a minimum annual processing capacity of 36 million barrels, even without the introduction of new process / technology, may qualify for pioneers status. <p>Similar projects regardless of capacity but locating in Visayas or Mindanao may qualify for pioneer status.</p> <p>Further processing of refinery petroleum products leading to another product may also qualify for registration.</p> <ol style="list-style-type: none"> 3. Production of organic fertilisers of plant animal origin may be registered, including production of microbial fertiliser with nitrogen-fixing organism and mycorrhiza <p>Mere mixing and compounding of organic fertilisers are not covered Only pioneer new and expansion projects may be registered.</p>
C. Sugarcane plantation/ sugar mills/ sugar refineries (P/NP)*	<p>Sugarcane plantation; sugar mills; and Refineries.</p> <p>New and expansion projects must be endorsed by the Sugar Regulatory Administration (SRA) and Department of Agriculture (DA).</p>
D. Packaging products (P)	
E. Machinery and Equipment and/or their parts and components (P/NP)*	<ol style="list-style-type: none"> 1. Metalworking and woodworking machinery; 2. Special purpose industrial machinery; 3. Agricultural machinery; 4. Equipment for power generation; 5. Communication equipment and apparatus; 6. Office computing and accounting machinery; and 7. Medical equipment/devices <p>Radio and television are limited to modernisation only.</p>
F. Coconut plantation and coco mills/refineries (P/NP)*	<p>Coconut plantation and oil mills and refineries.</p> <p>New coconut oil mills (crude) may be allowed provided these are integrated with plantation. (Plantation refers to planted areas with coconut trees still in their pre-production stage.)</p>
G. Fishery production (P/NP)*	<p>Fish, crustaceans, and mollusks</p>
H. Feeds production (P/NP)	<ol style="list-style-type: none"> 1. Feeds for aquaculture and livestock 2. Feeds production, integrated with corn production and/or other feed ingredient

production, may qualify for pioneer status.

IV. Support Activities

A. Infrastructure(P/NP)*

1. Development of industrial states;
2. Industrial communities;
3. Service cities;
4. Telecommunications;
5. Ports;
6. Water supply;
7. Water way and sewerage systems;
8. Toll roads/highways
9. Power generation and transmission; and
10. Distribution facilities for refined petroleum products/liquefied petroleum gas (LPG), including handling.

B. Common Carriers(P/NP)*

1. Land Transport*
2. Air transport facilities
3. Inter-island shipping*
 - a) pure cargo vessels; and,
 - b) passenger-carrying vessels

C. Agricultural services related to crops, livestock, fish production and post-harvest facilities (NP)*

1. Establishment and operation of facilities that render services to agricultural and fishery producers
 - a) cold storage;
 - b) farm machinery & equipment services; and
 - c) irrigation; etc.

Registered operators may be allowed to utilise not more than 20% for its own requirements

2. Ice plant projects, as a separate activity, may be registered if they locate in less-developed areas or Key Production Areas (KPAs) identified by the DA.

D. Environmental / Ecological Support Facilities

Environmental degradation/abatement/mitigation and ecology management/ maintenance (P/NP)

1. Development or conversion of industrial estates into industrial ecosystems
2. Industry self-regulation/upgrading at plant/ firm level
3. Establishment of toxic and hazardous wastes (YHW) merchant facility
4. Establishment of new or expansion, rehabilitation, modernisation of sewerage systems for industrial/municipal wastes*
5. Restoration/rehabilitation of major water catchment basins/ water ways and related infrastructures, man-made or natural.
6. Establishment of stationary and Mobile facilities for emission-testing.

E. Research and development activities (P)

1. In-house R & D activities of any manufacturing/producing firm; and,
2. Commercial R & D activities of private firms and research institutions.

F. Support to other government priority programs

1. Rice and corn production (NP)

Growing and cultivation of rice and corn up to storing and drying.

2. Production & processing of livestock and poultry (NP)

1. Production of swine or poultry;
2. Cattle raising for beef and/or dairy; and
3. Crocodile farming (excluding game animals/fowls and other species for pet /pleasure purposes)

Contract growers and integrators may be registered jointly or separately. Preferred areas are listed in the Key Livestock Development Areas of the Dept. of Agriculture's Medium Term Agricultural Development plan.

3. Housing components for socialised/ low cost housing projects (P/NP)
- Fabrication of major mass housing components using non-traditional, structurally-sound, environment-friendly materials/technology: roof/framing systems; partition systems; flooring systems; door/window systems; finishing/ceiling systems; and water /sewerage systems.
- Products other than steel-based should conform with Modular Coordination System (MCS) of the Construction Industry Authority of the Philippines.
- Endorsement by both the Housing and Urban Development Coordinating Council and the DOST is required.

4. Motor vehicle parts and components (P/NP)*
- Manufacture of parts and components for the motor vehicle industry.

5. Social services (P/NP)*
- Establishment of: Educational /training institutions; rehabilitation centers; health service facilities and new retirement villages.

Application for registration of health services must be endorsed by the Dept. Of Health (DOH). Projects must locate in an area identified by the DOH while educational and training institutions must be endorsed by TESDA and DOST. Applications for retirement villages must be endorsed by the Philippine Retirement Authority.

6. Tourism(P/NP)*
- Tourist accommodation facilities; tourism estates; eco-tourism projects and tourists buses.

New, expansion and modernisation of tourist accommodation facilities in Metro Manila may be registered but limited to capital equipment incentives only. Application for registration must be endorsed by the DOT.

V. Mandatory Inclusions

A. Mineral resources (R.A. No.7942) (P/NP)

1. Exploration of mineral resources

Qualified Projects:

- a) Projects with approved exploration permit, mineral agreement or financial and/or Technical Assistance Agreement (FTAA) under E.O. 279, series of 1987 or under R.A. No. 7942;
- b) Projects are not entitled to ITH.

2. Mining quarrying and processing of minerals*

All processing projects must locate outside NCR.

Qualified projects:

- a) Projects involving, quarrying and processing of mineral except those involving river bed operations, cave mining and beach mining.
- b) All marble processing projects, whether or not integrated with mining or quarrying, to qualify for registration, must export at least 50% off production, if Filipino-owned and at least 70% of production, if foreign-owned.
- c) Projects with approved FTAA under E.O. 279, series of 1987 or under R.A. 7942 are considered pioneer with ITH limited to four (4) years for new projects unless complying with Art. 17, Title 1 of E.O. 226, as amended. Foreign-owned corporations as defined under R.A. 7942 and holders of valid mineral processing permit, may register their mineral processing projects on pioneer status but with ITH limited to four (4) years for new projects unless complying with either criterion under Art. 17, title 1 of E.O. 226, as amended.
- d) Projects that will involve only mining or quarrying without processing shall be entitled only to capital equipment and non-fiscal incentives.
- e) Mining or quarrying integrated with mineral processing shall be entitled to

	full incentives.
	f) Processing without mining or quarrying shall be entitled to full incentives.
B. Iron and steel (RA No. 7103-Iron and Steel Act) (P/NP)*	<p>The following may be registered only on pioneer status:</p> <ol style="list-style-type: none"> 1. Basic iron and steel-making integrated with slab-making; 2. Flat products; 3. Seamless pipes production; 4. Long products; 5. Galvanising integrated with steel fabrication in support of infrastructure projects such as transmission towers, electric poles, highway guards, pier sheet pilings, industrial tanks, structural bridge members, street light poles, steel columns and beams for industrial plants and buildings, agricultural grain silos and highway steel culverts; and, 6. Fabricated steel structural members produced from computer-added process in support of infrastructure projects, such as in reinforced-concrete bridges, highways, overpasses, skyways, and industrial plants and buildings.
C. Industrial tree plantation (P) Section 36 (f) of P.D 705	<p>Establishment of forest tree plantations: rubber; bamboo; non-timber forest species for commercial and industrial purposes.</p> <p>The activity may be integrated with nursery establishments. The plantation may be on private land or covered by an Industrial Forest Management Agreement (IFMA).</p>
D. Book publishing (Sec. 12, R.A. 8047 or the "Book Publishing Industry Development Act") (P/NP)	<ol style="list-style-type: none"> 1. Production of books 2. Production of textbooks <p>Application for registration must be endorsed by the National Book Development Board.</p>
E. BOT projects (R.A. 6957, as amended by R.A. 7718)P/NP)*	Construction, rehabilitation, improvement, betterment, expansion, modernisation, operation, financing and maintenance of the infrastructure projects.
F. ASEAN Industrial Cooperation (AICO) projects (P/NP)	<p>Manufacture of all products, other than those in the General Exception List of the Common Effective Preferential Tariff (CEPT) scheme under the ASEAN Free Trade agreement (AFTA), shall be eligible for registration. An ASEAN Industrial Cooperation(AICO) Arrangement is a cooperative arrangement consisting of a minimum of two participating companies from two different ASEAN countries.</p> <p>To form an ASEAN Industrial Cooperation (AICO) Arrangement, the prospective companies must fulfill the following criteria:</p> <ul style="list-style-type: none"> - be incorporated and operating in any ASEAN country; - have minimum 30% national equity ; and - undertake resource-sharing, industrial complementation or industrial cooperation.

Note: P denotes "pioneer areas" ; NP denotes "non-pioneer areas"

* With modernisation program

Source: BOI, 1997a.

REFERENCES

- Aldaba, R., 1994, "Foreign direct investment in the Philippines: a reassessment", *PIDS Research Paper Series No. 94-10*, Philippine Institute for Development Studies, Makati.
- APEC, 1995, "APEC non-binding investment principles," *ASEAN Economic Bulletin*, pp. 363-365, Jakarta.
- Austria, M., 1996, "The effects of the MFA phase out on the Philippine garments and textile industries", in Intal, P. et. al., *The Emerging World Trading Environment and Developing Asia: The Case of the Philippines*, Asian Development Bank, Manila.
- _____ and Medalla, E., 1996, *A Study on Trade and Investment Policies in Developing Countries: the Case of the Philippines*, Institute of Developing Economies, Tokyo, Japan.
- Board of Investment, 1987, *The Omnibus Investments Code of 1987, Executive Order No. 226*, Makati.
- _____, 1997a, *1997 Investment Priorities Plan*, Makati.
- _____, 1997b, *Primer on Investment Policies in the Philippines*, Makati.
- Department of Trade and Industry, 1996, *Foreign Investments Act of 1991 R.A. 7042*, Makati.
- East Asia Analytical Unit, 1997, *A New Japan? Change in Asia's Megamarket*, Australia.
- GATT Secretariat, 1993, *The Philippines*, Trade Policy Review, Vol. 1, Geneva.
- Jun, K.W., Sader, F., Horaguchi, H. and Kwak, H., 1993, 'Japanese Foreign Direct Investment: Recent Trends, Determinants and Prospects', *Policy Research Working Paper 1213*, The World Bank.
- Kawai, H., 1994, "International Comparative Analysis of Economic Growth: Trade Liberalization and Productivity", *The Developing Economies*, 32(4): 373-397.
- Medalla, E. et. al., 1995, *Catching Up With Asia's Tigers*, Philippine Institute for Development Studies, Makati
- Okamoto, Y., 1996, "FDI, employment and production efficiency in the Philippines: Does APEC liberalisation matter?", *Working Paper Series No. 13*, Institute of Developing Economies.
- Takeuchi, J., 1995, "Trends and prospect for foreign investment in ASEAN countries in 1990's," *RIM Pacific Business and Industries*, 1(27):22-41.

- Tecson, G., 1995, "*Desiderata for Future Philippine-Japan Economic Relations*," Quezon City; UP School of Economics.
- United Nations, 1991, *Government Policies and Foreign Direct Investment*, New York.
- Urata, S. and Tullao, T., 1995. *Foreign Direct Investment: Gearing Towards Stronger Philippine-Japan Economic Relations in the 90's and Beyond*, Manila.
- Warr, P., 1985, *Export Processing Zones in the Philippines*, ASEAN-Australia Economic Papers No. 20, Kuala Lumpur and Canberra, Australia.
- _____, 1988, *Exports Processing Zones: the Economies of Enclave Manufacturing*, Canberra, Australia.
- World Bank, 1997, *Philippines Managing Global Integration*, Background Papers Volume 2, Washington D.C.