PN-ABE-493
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PHILIPPINES
MAI RECONNAISSANCE MISSION

BRIEFING MATERIALS

ORIENTATION MEETING
March 15, 1990

Jointly Sponsored By:

The Agency for International Development
Bureau for Asia, Near East, and Europe
Bureau for Private Enterprise
The U.S. - Philippine Business Committee

Note

Ernst & Young was the prime contractor for the Private Enterprise Development Support Project II (Project Number 940--2028.03) until October 1, 1991. On October 1, 1991, this project was transferred to Coopers & Lybrand, which is now the prime contractor. Because this report was produced prior to October 1, 1991, it may contain references to Ernst & Young.

Philippines MAI - Reconnaissance Mission
Briefing Materials
Table of Contents

U.S.-Philippine Business Committee

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U.S. MAI RECONNAISSANCE MISSION TO PHILIPPINES

MISSION OUTPUT (SUGGESTED FRAMEWORK)

I. Identification of Business Opportunities under the MAI

A. Sector-specific
B. Trade or investment
C. Level of specificity (sector, subsector, project, region, etc.) to vary according to sector and perceptions of mission members

D. Opportunities defined according to:

1. Conformity with MAI/PAP priorities/objectives
2. Potential for U.S. business (trade or investment) participation in infrastructural projects
3. Potential for attracting greater amounts of U.S. investment and trade in longer-term

II. Philippine Policies and Regulations

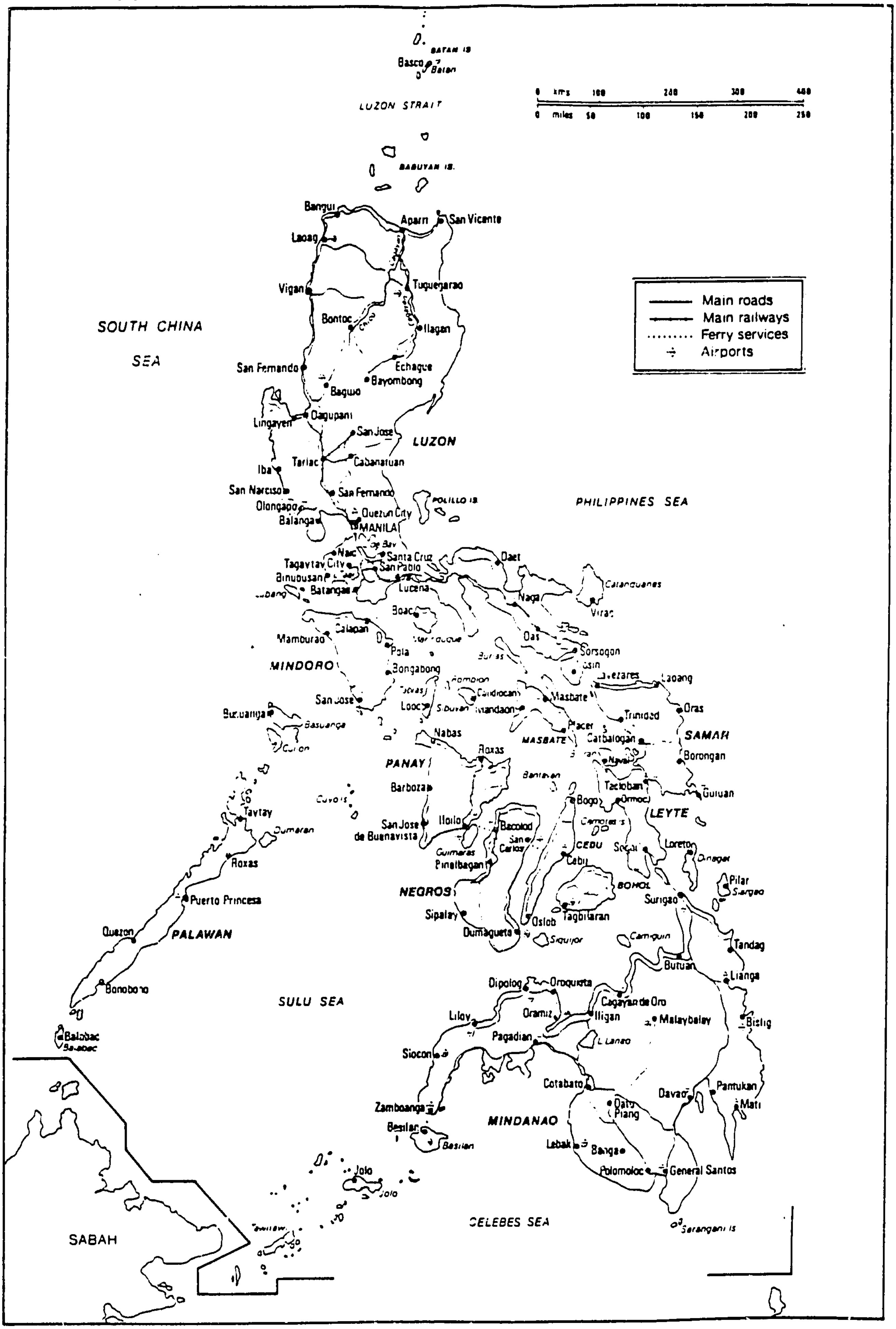
A. Identification of sector-specific or general policy obstacles, or areas where laws inadequate to protect investors
B. Recommendations on policy changes, new investment incentives etc. to improve overall or sector-specific business climate

III. Programs to Encourage Business Participation in MAI (including projects funded by Japan, World Bank, ADB, etc.)

A. Recommendations on follow-up mechanisms to promote business opportunities, gather early warning on possible ventures and disseminate information to U.S. business community
B. Recommendations on new U.S. government/private-sector programs to make U.S. firms more competitive and enhance their chances for success

2

The Philippines



MISSION ITINERARY

MAI RECONNAISSANCE MISSION
PROPOSED ITINERARY
March 25-31, 1990

Saturday, March 24

Proposed arrival of all MAI Reconnaissance Mission Participants

Sunday, March 25

6:00 - 7:00 p.m. - Cocktails/Orientation

Monday, March 26

8:15 - 8:30 - Welcome

8:30 - 10:00 - US Government Perspective on Business in the Philippines

- Welcome: **Minister Kenneth Quinn**, Deputy Chief of Mission
- Overview of the MAI/PAP: **Malcolm Butler**, Director, USAID Mission
- Q & A

10:00 - 10:15 - Coffee Break

10:15 - 11:30 - U.S. Perspective, continued

- Overview of the Economy: **John Modderno**, Economic Counselor
- Business Climate and Opportunities: **Ted Villinski**, Senior Commercial Officer, Foreign Commercial Service
- Q & A

12:00 - 1:30 - Lunch

Hosted by RP-US Business Council; **Victor Lim**, Acting Chairman
Both morning and afternoon participants invited to attend

2:00 - 4:00 Philippine Government Perspective on PAP and Infrastructural Development

Presentations by:
- Department of Finance
- BOI/DTI
- NEDA/CODA
- Q & A

Itinerary

Monday, March 26, cont.

4:00 - 4:15 - Break

4:15 - 4:45 - Discussion and Wrap-up

6:00 - 8:00 - Reception
Minister Kenneth Quinn
Hosted by U.S. Embassy

Opportunity for U.S. and Philippine Business representatives to get acquainted

Tuesday, March 27

7:30 - 9:00 - Working Breakfast
Hosted by the Board of the American Chamber of Commerce; **Mark Blacker**, President

9:00 - 10:30 - Presentation by **Roberto Villanueva** and CCPAP staff

10:30-10:45 - Coffee Break

10:45 - 12:15 - Briefing on Multilateral Donor MAI Activities

- Japan: Embassy official in charge of economic assistance
- World Bank/IFC: Head of the Philippine office
- ADB: Officer in charge of lending to the Philippines
- Q & A

12:30 - 2:00 - Lunch
Congressman Margarito Teves and **Senator Vicente Paterno** - Congressional representatives working on investment code reforms

2:15 - 5:00 - Sectoral Working Groups

Sectoral specialists from the U.S. Embassy and AID Mission, the American Chamber of Commerce, RP-US Business Council, the World Bank/IFC, Japan, and the ADB brief mission participants on key issues in their respective sectors.

Tuesday, March 27, cont.

7:00 p.m. - Sectoral Dinners

Hosted by the American Chamber of Commerce and the US - Philippine Business Committee. Mission participants will remain in their sectoral groups and be joined by U.S. and Philippine business representatives from their respective sectors for dinner.

Wednesday, March 28

7:30 - 9:00 - Working Breakfast -
Hosted by Philippine Chamber of Commerce and Industry
Panel on Philippine Business View of the PAP, Infrastructure, and Possible Business Linkages with the U.S. Private Sector
Chaired by **Aurelio Periquet**, PCCI President

9:00 - 9:30 - Economic Development Foundation: Presentation on the PAPS Pre-Investment Facility
Victor Taylor, President

10:00 - 6:00 - Sectoral Meetings and Visits

Mission Participants visit sector-specific private businesses and government offices.

Wednesday evening:

Agribusiness, Environment, Finance, and Transport specialists fly to Cebu.

Thursday, March 29 and Friday, March 30

Thursday Morning:

Agribusiness, Environment, Finance, and Transport specialists fly on to General Santos for two days of sectoral meetings.

Energy and Telecommunication specialists remain in Manila area and continue sectoral meetings all day Thursday and Friday.

Thursday, March 29 and Friday, March 30, cont.

Friday Evening:

Participants return from General Santos.

Sectoral groups begin to collate their findings and conclusions.

Saturday, March 31

8:00 - 10:00 - Working Breakfast

Each sectoral group wraps-up its findings and conclusions and prepares them for presentation to the entire group.

10:15 - 12:00 - Presentation of Major Findings

Each sectoral group presents its findings: areas of interest to US investors, policy affecting sectoral investment, etc. US government representatives, and US business people will be invited to attend.

12:30 - 2:00 - Lunch

An informal meeting with all those who have participated in the weeks' meetings, allowing mission participants to brief them on preliminary findings. Seating will be arranged by sector to facilitate exchange.

2:00 - 5:00 - Working Group

Explore possible new mechanisms to implement team findings. US Government representatives will be present.

End of Mission

RECONNAISSANCE MISSION PARTICIPANT BIOGRAPHIES

MAI RECONNAISSANCE MISSION
PARTICIPANT BIOGRAPHIES

Kenneth M. Aoyama
Chairman and CEO: AG West Group, Ag West International Ltd.
President and CEO: Seyama Pacific Limited

As Chairman and CEO of the AG West Group, Kenneth M. Aoyama ensures that the company objectives of identifying potential business activity in the fields of Agriculture, Forestry, and Food Processing are being met.

Ag West Group was formed in 1985 as a holding company for Seyama Pacific Limited and Ag West International Limited. Mr. Aoyama is President and Chairman of these two firms respectively. Ag West International is an international agricultural engineering and food processing engineering company. Seyama Pacific Limited is a joint venturing company in the People's Republic of China.

Prior to working with the Ag West companies, Mr Aoyama started Poly Ag Inc., a commercial mechanical winegrape harvesting company; served as president and chairman of Cal Delta Farm, Inc., a 2500-acre diversified farming company; and served as a Captain in the U.S. Marine Corps.

Mr. Aoyama holds a BS in Mechanized Agriculture from California State Polytechnic University.

Frank E. Butters
General Manager, Southern Region, Sea-Land Service

Frank E. Butters has worked with Sea-Land for over twenty years. He is currently responsible for the management of sales for thirteen of the Southern States, Mexico, the Caribbean, and Latin America.

He has served as Manager of Sales for two years in Sea-Land's Hong Kong office and as Manager of Sales and Outport Operations for two years in the Manila office. Prior to joining Sea-Land in 1966, Mr. Butters served for three years in the U.S. Army. He holds a BA from Grove City College.

Humbert R. Causing
Vice President and Regional Manager - Asia
Morrison-Knudsen International Company

As Vice President and Regional Manager of the Asia region for Morrison-Knudsen, Humbert R. Causing is responsible for the supervision and control of marketing, project finance, and investment in Asia. This includes business development, proposal preparation and presentation, and contract negotiations. Mr. Causing originally joined Morrison-Knudsen as Project Director of engineering for the Inga Shaba Intertie, Republic of Zaire.

Mr. Causing has nearly 40 years of professional, worldwide experience in virtually all major aspects of civil engineering design, construction, and construction supervision. He has worked on projects in Honduras, El Salvador, Niger, Tunisia, Chile, South Korea, Algeria, and Columbia.

Mr. Causing holds a MS in Engineering from Princeton University and a BS in Civil Engineering from Silliman University. He is a registered civil engineer in the Philippines, Columbia, and Chile.

Allen C. Haile
Manager of Infrastructure Development, Bechtel Corporation

Allen C. Haile has been with Bechtel Corporation for nine years. He currently serves as Manager of Infrastructure Development. His work is focused on the Philippines and other Pacific Rim countries. Prior to joining Bechtel, Dr. Haile served as a Regional Representative for the US Department of Commerce, with emphasis on the Pacific Basin. He has also held positions at Pepperdine University, the Rand Corporation, and in the US Air Force.

He has broad experience in international development, including human resource development, implementation, and formation of human resources, and manpower development projects.

Dr. Haile holds a Ph.D and an MPA in Public Administration from the University of Southern California, an MS in Systems Management from the University of Southern California, and an AB in International Relations from the University of Nebraska.

Harry Johnston
Vice President, International and Federal, GTE Hawaiian Tel

Harry Johnston was appointed Vice President - International and Federal in April 1989. He is responsible for business development and sales growth in international and federal markets in Hawaii, Asia, and the Pacific Basin.

Mr. Johnston joined Hawaiian Tel in 1984, after working with AT&T Network Systems for 16 years. He was director of network marketing at Hawaiian Tel before leaving to serve as product manager at the GTE headquarters in Stamford, Connecticut in 1987.

Mr. Johnston holds a B.S. in engineering from California State University at San Jose.

Joe Ben Laraya
President and Managing Director, Dole Asia

As president and managing director of Dole Asia, Joe Ben Laraya oversees the expansion of Dole's operations in Asia.

Joe Ben Laraya first joined Dole Philippines in 1965. During his first 15 years with the company he was vice president and general manager of Dole Thailand for four years and Standard Fruit Philippines for another four years. He left Dole in 1980 to join the Philippine National Steel Corporation.

At that time National Steel was experiencing significant financial loss. Under Mr. Laraya's leadership, revenues increased by over 600% and by 1988, the company recorded a record profit of more than $40 million.

Ian Lutes
Vice President - International Sales
Foster Wheeler Energy Corporation

Ian Lutes was appointed Vice President - International Sales for Foster Wheeler Energy corporation in December 1989. Foster Wheeler Energy designs and fabricates steam generating equipment for electric utilities, industrial users and public authorities.

Prior to his appointment as Vice President of Foster Wheeler, Mr. Lutes served as General Manager of Generadores de Vapor Foster Wheeler in Madrid, Spain from 1987-1989. He previously held the positions of Manager of Business Development - fluidized bed Boilers for Foster Wheeler boiler corporation; Manager of Industrial Boiler Sales; Sales Manager and Director of Licensing for Foster Wheeler Energy Corporation. Prior to his career with Foster Wheeler, Mr. Lutes was employed by Copeland Systems of Oak Brook, Illinois.

Mr. Lutes received a Bachelor's degree in mechanical engineering from the University of New Brunswick, Canada.

Rom Michalek
Deputy Director, Technical Assistance, The World Environment Center

Rom Michalek is the Deputy Director of Technical Assistance programs for the World Environment Center. The World Environment Center works with 56 multinational corporations to provide environmental management to developing countries. The center is funded by USAID.

Prior to joining the Wold Environment Center, Mr. Michalek served as Manager of Business Development and Planning for the Engelhard Corporation; in that capacity he identified, evaluated, and directed the development of new business opportunities for the Environmental, Specialty Chemicals, Specialty Metals, and Chemotherapy Group businesses. Earlier, he managed the engineering and environmental engineering departments. Mr. Michalek was with Engelhard for over twenty years. Prior to joining Engelhard he worked for three years with Halcon International.

Mr. Michalek holds an MBA from Farleigh Dickinson University, an MS in Chemical Engineering from New York University, and a BS in Chemical Engineering from the Polytechnic Institute of Gliwice, Poland. He is a professional engineer.

Richard Serikaku
Vice President and Area Manager, Pacific Area, Motorola Inc.

Richard Serikaku has served as Vice President and Area Manager of the Pacific Area for Motorola for 2 years. His responsibilities include the distribution of Motorola's Communications Sector products, and the provision of service and engineering support, infrastructure development, and revenue business for the products distributed.

Mr. Serikaku has extensive experience in Asian telecommunications systems; he has worked on projects in Hawaii, Alaska, Guam and the Philippines.

Albert J. Smith, III
Vice President, International Markets, Destec Energy

Albert J. Smith was appointed Vice President of International Markets for Destec Energy in February 1990. As Vice President, Mr. Smith identifies and develops projects in all countries other than the United States and Canada. Prior to this appointment, Mr. Smith was a Director, Vice President - Corporate Development and General Counsel for PSE, Inc., a company with over twenty years experience in the design, development, and operation of private power companies. PSE was acquired by Destec in December 1989. Prior to joining PSE in 1985, Mr. Smith was an associate with Liddell, Sapp, Zivley, Hill and LaBoon of Houston, Texas.

Mr. Smith received his Doctor of Jurisprudence from the University of Texas in 1981 and a B.A. in Economics from Princeton University in 1976. He is member of the State Bar of Texas and the Order of the Coif, an honorary legal fraternity.

Eldridge D. Wood, Jr.
Chairman and President, Inter-Pacific Capital Corporation

Eldridge D. Wood has been Chairman and President of Inter-Pacific Capital Corporation since 1983. Inter-Pacific Capital plans, organizes, and finances direct investment in the United States and the countries of East Asia; activities include mergers, acquisitions, divestment, and finance. Mr. Wood is also a Special Limited Partner in Ventana Growth Fund II and Ventana Japan L.P..

Prior to joining Inter-Pacific Capital Mr. Wood was Senior Vice President and Chief Operating Officer of Private Investment Company for Asia (PICA) S.A.. He also worked for PICA in the Philippines for five years, first as Representative and then as Vice President. Mr. Wood has also been with Ralston Purina in Japan, and with William H. Rennolds Company in the Philippines.

Mr. Wood holds an MBA from the University of Chicago and a BS in Business Administration from Northeastern University.

BACKGROUND INFORMATION ON THE MAI/ PAP

THE MULTILATERAL ASSISTANCE INITIATIVE/ PHILIPPINE ASSISTANCE PROGRAM

BACKGROUND

In 1987 Senators Cranston and Lugar and Congressmen Solarz and Kemp proposed to President Reagan that the United States explore the establishment of a multilateral aid program for the Philippines. On July 3, 1989, their proposal came to fruition at a Consultative Group (CG) meeting in Tokyo: 19 countries and 7 international organizations announced the formation of the Multilateral Assistance Initiative (also known as the Philippine Assistance Program [PAP] in the Philippines). Participants pledged $3.5 billion in assistance to the Philippines. The United States pledged $1 billion over the life of the project. The Administration requested $200 million for FY90; Congress appropriated $160 million, with transfer authority for an additional $40 million, should funds become available. The administration has requested $200 million for FY91.

The purpose of the MAI/PAP is to support democracy in the Philippines by promoting broad-based economic growth. It is a unique aid initiative in that it coordinates the development efforts of a large number of donors with the Philippine Government and the private sector.

Under the MAI/PAP, the role of the public sector is an enabling one; the project encourages government reform of policy and the creation and maintenance of infrastructure, so that the private sector can more effectively operate in the Philippines. It is envisioned that private sector investment will help raise employment levels and standards of living. Thus, involving the resources of the private sector is the key to the success of the MAI/PAP. As Carol C. Adelman, AID Assistant Administrator for Asia, Near East, and Europe, has said, if MAI succeeds, "the need for extraordinary official assistance will gradually decline...a pattern of self-sustained, broad-based growth fueled by the private sector will be established."[1]

In keeping with the Philippine Medium Term Development Plan (for the years 1987-1992) the MAI/PAP seeks to reduce poverty through job creation and expanded opportunities provided by private sector-led growth. One of the main vehicles for doing so will be the promotion of Economic Development Zones (EDZs) around the country. Five zones have been identified. The guiding principles for the allocation of MAI/PAP funds are outlined below.

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[1] Carol C. Adelman in testimony before the Subcommittee on Asian and Pacific Affairs of the House Foreign Affairs Committee. March 7, 1989.

Projects must:

- Rapidly expand the productive capacity of the economy;

- Throughout the country lay the foundation for a balanced and well-dispersed private sector economy;

- Engage in catalytic projects which should be able to create ancillary activities, attract substantial flows of private investment, and generate employment;

- Give priority to high value-added products, preferably using indigenous raw materials, with immediate export potential; and

- Encourage activities which will improve the over-all socio-economic standing of the Philippine beneficiaries.

In order to facilitate the use of assistance provided by the MAI/PAP, President Aquino established a **Coordinating Council of the PAP** (CCPAP), in January 1989. CCPAP is composed of executive, legislative, and private sector representatives; its offices will serve as the point of communication between donors and the Government of the Philippines (GOP). It is headed by a prominent Philippine businessman, Roberto Villanueva. Also established in 1989, as an arm of the National Economic and Development Authority (NEDA), was the **Committee on Official Development Assistance** (CODA). CODA coordinates the use of <u>all</u> development assistance by GOP executive agencies. Mr. Villanueva heads CODA as well.

President Bush has named Ambassador Elliot Richardson as his Special Representative to the MAI/PAP. Richardson maintains liaison contact with CCPAP Chairman Villanueva and major MAI donors, supports US MAI appropriation requests before the US Congress, and promotes US investment in the Philippines.

UNITED STATES PROGRAMS UNDER MAI/PAP

The first US project under the MAI/PAP is called the **Philippine Assistance Program Support Project** (PAPS). PAPS is aimed at assisting the Philippines with the development and implementation of high-priority projects under the MAI/PAP. The project has a projected budget of $32 million over the next five years; $7 million of that is to be provided by the GOP and the private sector, the rest by AID.

PAPS has three components:

- Funding of feasibility studies;
- Support of CODA operations; and
- Development of a private sector Pre-Investment Program.

The first and second components account for $20 million of the projected AID budget, with the Pre-Investment Program accounting for the remaining $5 million.

The studies component of PAPS will produce analytical information on infrastructural sectors that will help the GOP implement the investment component of the MAI/PAP. Focus will be on investments which will have a positive impact on private sector growth and development. Areas which might be studied include:

- Economic development zones
- National infrastructure
- Local government projects
- Non-project planning, sectoral and issue-related studies

Absolute criteria for study proposals are parallel to those used in allocating funds under the MAI/PAP. In addition, priority will be given to proposals which carry out studies in targeted rural areas; projects must be able to demonstrate a likelihood of project financing. Linkages to the private sector are highly desirable, as is the introduction of new technology, and the possibility that a final project might produce trade links, particularly with the U.S.

There are three areas of support which PAPS will provide to CODA, as follows.

- **Institutional development support:** CODA staff will be trained in how to screen project proposals, identify the need for feasibility studies, develop scopes of work, and other skills necessary for running the CODA programs.

- **Provision of technical specialists:** Specialists are to assist in programming and monitoring PAPS funds. Fields of specialty will include project design, engineering and environmental assistance. Assistance in these areas will help CODA conduct a wide-range of feasibility studies, while meeting donor standards for follow-on project financing.

- **Provision of basic office equipment and supplies.**

Of particular note to U.S. companies interested in investing in the Philippines is the third component of PAPS - the **Private Sector Pre-Investment Program.** According to the PAPS Concept Paper "the Pre-Investment Program will <u>promote private investment by reducing pre-investment risk and assisting potential project sponsors in identifying business opportunities and developing bankable projects</u>."

The **Pre-Investment Facility** (PIF), run by USAID/Philippines and

the Economic Development Foundation, will fund up to 50% of feasibility studies of private companies interested in investing **in** the Philippines. Studies may include market, distribution, technical, organizational, or financial research. Projects will go through a three stage approval process based on the following criteria:

<u>Stage I - Necessary Elements</u>

1. Investors must be part of the **private sector.**
2. Investors must have **credibility** based on the following elements:
   - Proof of intent to carry through with investment
   - Experience in sustained investment
   - Proof of financial capability - ie. equity and access to loans
   - Access to necessary technology
3. Investors must meet the **nationality** criteria. Projects must be wholly U.S. or Philippine owned, or be joint ventures with at least 20% U.S. equity investment.

<u>Stage II - Desirable Elements</u>

1. The project should **align with the national investment priorities.**
2. The project should be **located in one of the five regional growth centers** targeted by the PAP.
3. Necessary **infrastructure should be available** in the region where the project will be located.
4. The project should be **environmentally sound.**
5. Ideally, the project will have a **favorable foreign exchange impact.**
6. The project should **use proven technologies.**
7. The degree of **employment generation** is a consideration.
8. **Linkage with small and medium scale enterprises** is favorable.
9. The existence of **available credit** is a favorable factor.

<u>Stage III - Study Criteria</u>

1. **Soundness and comprehensiveness in study scope** will be a consideration.
2. Those undertaking the study should have a demonstrated **capability** to do so.
3. The study **schedule** must be reasonable.
4. The study **budget** must be reasonable.

MAI/PAP

When a study is determined to meet the requirements for eligibility, the investor then enters into a Reimbursement Agreement with the PIF. The PIF conditionally commits to reimburse 50% of study costs, up to $250,000; 25% of study costs, up to $125,000, will be reimbursed upon study completion, the other 25% when the investment is made. Reimbursement is conditional upon the PIF's satisfaction that the study has been carried out according to the pre-set scope and budget.

The United States intends to develop a number of other programs of assistance under the MAI/PAP during the coming year, above and beyond the PAPS. These include a project to improve environmental and natural resource management, and the funding of several infrastructure projects in General Santos City in Mindanao. Also under consideration are several projects in the energy and telecommunications sectors.

OTHER DONOR ACTIVITIES UNDER MAI/PAP

Attached are lists of funds committed to the MAI/PAP by country. Some of these countries have earmarked their funds; the general areas of focus that they will emphasize are noted. CCPAP is in the process of coordinating information on the exact activities that the major MAI/PAP donors - the US, Japan, the World Bank, and the Asian Development Bank - will be underwriting. The World Bank and the Asian Development Bank allow the participation of US firms in their programs. Furthermore, in late 1989 Japan announced that it will begin to allow non-Japanese companies to become involved in Japanese aid projects. Thus, opportunities for involvement by US firms in MAI/PAP projects beyond those funded by the United States may arise.

Periodic meetings have been held in Manila on specific sectors affected by the MAI/PAP. These meetings are known as mini-Consultative Groups or mini-CGs. They are intended to improve donor coordination with the Philippine government, in order to implement better the programs discussed at these meetings.

A mini-CG held in October 1989 on the implementation of projects resulted in improvement of Philippine government procedures to expedite the often complex process between the initiation and the completion of projects. A second mini-CG was held in February 1990 on the environment and natural resources, at which the Philippine government explained its Strategy for Sustainable Development, adopted by the Philippine cabinet in November 1989. The next mini-CG will be held on agrarian reform. The date is as yet unannounced.

CONCLUSION

The MAI/PAP is an exciting new experiment in international aid programming. It is a highly targeted project, aimed at uniting the efforts of 26 countries and international donor organizations in order to promote broad-based economic growth in the Philippines. If successful in coordinating donor activities and mobilizing the private sector as a fundamental part of its structure, it will prove to be a means of expanding development assistance resources and will serve as a prototype for future aid packages to other countries.

MAI-PAP: Funds Committed by Country 1989-90 (In U.S. Dollars)

WORLD BANK	$2 Billion over 5 years (plus incremental allocation for specific projects) - 25% for structural adjustment or 10% or Total Country Program (TCP) - supplemental = 15% of TCP	$700 Million - 750 (MAX)
ADB	$1.5 Billion over 3 years $15-20 Million for feasibility studies	$500 Million - 550 (MAX) 5 Million
JAPAN	$1 Billion (Y135 Billion) -$852 MM (Y115 B) soft loans for agri/ rural dev./ infra/ product. impl/ environment/ CALABAR/ poverty all (ODA for 75% of BX portion of project whichever is higher: finance local currency portion which [illegible] dev./ regional dev./ poverty alleviation -$150 MM grants (Y20 B) for capital and technical cooperation/basic human needs.	$1002 Million
USA	$1 Billion in grants over 5 years	$200 Million
BELGIUM	$4 Million	$ 4 Million
CANADA	$28.7 Million -$15.6 MM development assistance -$13.1 MM grants	$ 28.7 Million
AUSTRALIA	$132 Million over 5 years (A$175 MM) -$117 MM in grants -$15 MM in technical/ improvements in aid management	$ 26.4 Million
DENMARK	$13 Million in grants for water supply/ IAD/ environment/ rural development/ small power plants	$ 13 Million
FINLAND	No pledge authorized	
FRANCE	$150 Million over 4 years in soft loans -$53.9 MM in 1989 (Ff 350 MM) for energy and telecommunications -$5.1 Million in grants for scientific and technical studies/ cultural/ coconut/ aquaculture/ blood transfusions	$ 57 Million

FRG (GERMAN)	$57-54 Million broken down into -$31.4 MM in ODA soft loans -$10.46 MM in Technical Assistance -$ 2.6 MM in Sectoral Aid/Scholarships -$13.1 MM in direct assistance to NGOs (i-rate reduced to 35% over 10 years with 10 years grace) Possible matched funding from KFW on 1:1 basis with ODA soef component resulting in average rate of 2.2% effective Past usage for rural development/ SMSI/ health/ infra/ energy/ transport/ natural resources	$ 57.54 Million (Possible increase by $31.4 MM at K-bank rates)
ITALY	$270 Million up to 1990 (3-years) -$180 MM in soft loans -$ 90 MM in grants i-rate of 1-1/2 for 20 years with 10 years grace (Plus additional commited funds given to Agrarian Reform program over 3-year period of $50 million)	$115 Million
JAPAN	In addition to basic package $600 Million SDRs OA untied loans to be used for debt restructuring	$600 Million
KOREA	$.5 Million in technical assistance (Possible increase based on actual discussions plus possible assistance on special training programs)	$ .5 Million
NETHERLANDS	$18 Million (f40 Million) for rural development/ industrial development/ training and education research/ IAD/ role of women in dev./ agri/ ecology/ self-help groups	$ 40 Million
NEW ZEALAND	$1.136 Million over 5 years -$113,000 for 1st year	$ .113 Million
SINGAPORE	(Historically: $5 MM in past; form and quantum to be decided in consultation)	(Still open)
SWITZERLAND	$40 Million or Sf60 MM -40% or $16 MM in grants -60% or $24 MM SB commercial loan for humanitarian aid & technical assistance	$ 40 million

24

SPAIN	$73 Million for 1989-92 -$20 Million in grants -$53 Million in soft loans which can be stretched upwards depending on specific projects	$ 25 Million/yr. over 3 years
SWEDEN	Existing levels to be maintained which is approximately at $3.164 MM or Sk 20.6 MM of which -$583,000 for disaster relief and -$538,000 for NGOs	$ 3.164 Million
UK	$24 Million in 1989 by CDC $16 Million in 1990 by CDC Plus private investment from UK/HK of about $42 MM $ 8 Million Training Assistance over 4 years (grant) for livestock dev./ CARP/ project mgt./ institution bldg./ social services delivery/ (Plus open ended capital aid on case to case basis in form of grants to support commercial transactions)	$ 40 Million
E.C.	16 MM ECUs per year (Does not include possible grants which the EC may give on case to case basis.) Concerned with absorptive capacity/ strengthening of institutional frame- work and project management/ imple- mentation procedures/ financial flows/ area development -In 1992 EC will work for gradual reduction on restrictions on imports from RP.	$ 20 Million
SAUDI FUND	Willing to work on projects on a case to case basis	OPEN
UNDP/WFP/ UNICEF/UNFPA	$24 Million from various sources on one year basis; however: -$6.35 MM for 1989-90 (UNDP) -$15 MM new proposals -$25 MM (UN Population Fund) -$16.7 MM (UNICEF) -$21.5 MM supplementary/$10 MM by the end '89 -$26.9 approved IPF -$3 MM for NGOs/ Public sector development/ management dev./ natural resources/ science -$2 MM for management dev. programs	$ 24 Million

IFC	For 1988-89, guarantees worth $160 MM for next two years: $100 MM in support of projects by private sector investors in the fields of telecom/ power/ ports development/ export-oriented activities.	
GRANT TOTAL		$3479.417 Million
	ADD: Kfw Commitment	31.4
		$3510.817 Million

26

LOAN AGREEMENTS SIGNED, 1989
(In Million U.S. Dollars)[a]

Creditor/Particulars	Signing Date	No. of Loans	Loan Amount
Asian Development Bank		9	548.4
SMI-IGLF (US$65M + SDR25.852M)	17-Feb-89	2	100.0
Manila Water Rehabilitation II	17-Feb-89	1	26.4
Infrastructure Restoration Project (SDR 14.772M)	17-Feb-89	1	20.0
Fisheries Sector Program /x	05-Oct-89	2	80.0
Angat Water Supply	18-Dec-89	1	130.0
Fifteenth Power	18-Dec-89	1	160.0
Dev't for Low Income Communities	18-Dec-89	1	32.0
Int'l Bank for Reconstruction and Development		7	800.6
Finance Sector Loan /x	31-May-89	1	300.0
SMI IV	31-May-89	1	60.0
Manila Power Distribution	02-Aug-89	1	65.5
Industrial Investment Credit	09-Nov-89	1	65.5
Angat Water Supply	09-Nov-89	1	40.0
Health Development	09-Nov-89	1	70.1
Debt Management Loan /x	22-Dec-89	1	200.0
Overseas Economic Cooperation Fund		10	842.2
15th OECF Yen Loan Project Agreements (Yen30.995B)	26-May-89	8	242.2
Co-financing of the WB Financial Sector Loan (Yen 40.0B) * /x	23-Nov-89	1	300.0
Eximbank Parallel Financing with the IMF Principal Reduction /x	30-Nov-89	1	300.0
Germany		2	54.4
Meralco Substations (DM62.3M)	10-Jul-89	1	35.9
Energy Sector Loan (DM32.4M)	10-Jul-89	1	18.5
France		3	7.8
Crash Fire Rescue (FF19.0M)	31-Jul-89	2	3.1
Visayas Telecom (Credit Nationale) (FF28.5M)	10-Oct-89	1	4.7

LOAN AGREEMENTS SIGNED, 1989
(In Million U.S. Dollars)

Creditor/Particulars	Signing Date	No. of Loans	Loan Amount
Switzerland		1	24.7
Swiss Mixed Credit Facility (SFr36M) ***	10-Mar-89	1	24.7
U.K. - Bank of America		1	43.5
John Brown Gas Turbines (Stlg24.38M) ****	15-May-89	1	43.5
Canada		1	22.8
EDC Telecom (Con$27.1)	07-Nov-89	1.	22.8
Spain		1	2.2
PAL Automated Stores (Banco Exterior)	03-Nov-89	1	2.2
Brunei Investment Agency /x	06-Jul-89	1	100.0
TOTAL		36	2,466.5
of which Program Loans		7	1,280.0

Exchange Rates:

Yen/US$:	128.00
SFr/US$:	1.46
Stlg/US$:	0.56
DM/US$:	1.75
FF/US$:	6.06
Ds/US$:	1.19

* Dollar amount fixed at $300 million
*** Excludes grant component of SFr24 million (US$16.44 million)
**** Excludes grant component of Stlg13.13 million (US$23.45 million)

/x Program loan

a - As of 6 January 1990

2C

LOAN NEGOTIATED, 1989 /a
(In Million U.S. Dollars)

Creditor/Particulars	No. of Loans	Loan Amount
Int'l Bank for Reconstruction and Development	2	430.0
Energy Sector Loan /x	1	390.0
Municipal Development Loan	1	40.0
Overseas Economic Cooperation Fund	12	585.9
16th Yen Credit Projects (Yen 75 Bn)	12	585.9
France	1	4.6
Visayas Telecom (Banque Paribas) (FF27.7 Mn)	1	4.6
Spain	1	2.7
PAL Automated Stores (ICO)	1	2.7
TOTAL	16	1,023.2
of which Program Loans	1	390.0

/a In addition to loans signed during the year
/x Program Loan

Exchange Rates:

Yen/US$:	128.00
SFr/US$:	1.46
Stlg/US$:	0.56
DM/US$:	1.75
FF/US$:	6.06
Ds/US$:	1.19

29

JAPANESE ODA PROJECTS FOR PHILIPPINES

(AS OF 3/5/90)

YEN-CREDIT (16TH)

1. OVERPASS CONSTRUCTION (MANILA)
2. FREEWAY CONSTRUCTION (SOUTH LUZON)
3. BRIDGE REHABILITATION
4. DISASTER MEASURES FOR ROADS
5. FLOOD CONTROL
6. WATER SUPPLY SYSTEM IN RURAL AREA
7. NATIONAL COMMUNICATION SYSTEM
8. IRRIGATION
9. WEATHER COMMUNICATION SYSTEM

GRANT ('90 FORECASTED)

1. HIGHLANDS AGRICULTURE DEVELOPMENT
2. TEACHING EQUIPMENT FOR SCIENCE & HEALTH·PHYSICAL EDUCATION (ELEMENTARY & JUNIOR HIGH SCHOOL)
3. BRIDGE CONSTRUCTION
4. SCHOOL BUILDING CONSTRUCTION
5. SEWAGE DISPOSAL PLANT
6. ENVIRONMENTAL SANITATION PROGRAM IN RURAL AREA
7. IRRIGATION —
8. EXPANSION OF UNIVERSITY (ESTABLISHING A ENGINEERING DEPT)

30

DOING BUSINESS IN THE PHILIPPINES:

• THE INVESTMENT CLIMATE •

• INVESTMENT CODES •

• INVESTMENT INCENTIVES •

INVESTMENT CLIMATE IN THE PHILIPPINES, 1990

Introduction.

The Philippines, by and large, has not been well served by the media. Negative trends and events often have been exaggerated or have not been fully explained in their contexts. In part, the bad press is a function of rather tempestuous political events of the past decade played out in front of foreign television cameras, e.g. the assasination of Benigno Aquino in August of 1983, several years of massive anti-Marcos demonstrations, the overthrow and expulsion of Marcos in February, 1986 and graphic exposure of his government's and family's corruption, the series of unsuccessful coups against President Aquino by disaffected military men (who, many believe, are supported by various civilian figures), the killing of military personnel by the NPA. The continuous jockeying for political power also has hurt, particularly when figures close to the President have been openly critical of her and her government. The irresponsible reporting of rumors rather than facts by much of the local media only adds to the misunderstandings and exaggerations. However, for the potential investor, the greatest disservice has been the failure to analyze and report the quiet progress and improvement which is taking place in the investment climate. This short review will attempt to give a more balanced view of the Philippines by concentrating on the issues of direct interest to a potential American investor.

Macro-Economic Issues

Issue: <u>Stabilization of the Economy</u>. Is the economy sufficiently stabilized to allow sustained growth and to support recovery of investment?

The Philippine economy began to fall into basic disequilibrium in the late 1970s. Debt, current account deficits and inflation climbed and growth dropped precipitating a debt crisis in October, 1983. A period of austerity policies and political turmoil followed depressing growth rates, particularly growth of investment, still further. The years 1984 and 1985 were the worst for the economy in the postwar period.

The foundations for economic recovery began to be laid by the end of 1983 with the adoption of corrective monetary and fiscal policies. The economy slowly regained its equilibrium and by 1986 President Aquino was able to loosen very tight policies and to allow resumption of growth. What has frequently been overlooked is the fact that the fairly rapid return to equilibrium (compared to many other indebted countries) was achieved despite the declining credilibility and loss of legitimacy of the Marcos government and without the resort to direct controls used in the past. Instead, policies stressed adaptation to the harsh realities of limited financial resources and to market discipline.

Recovery of economic growth was rapid due to the unleashing of long suppressed and unsatisfied consumer demand (due to rising wages and employment), the repatriation of capital and new foreign capital invested in consumer goods production and real estate, post-Marcos euphoria, and the easing of monetary policies and import controls. It has been sustained by a generalized improvement in business strategy and operations, e.g. new and vibrant interest in exporting, greater attention to product quality, investment in upgrading capacity and production to improve competitiveness, reduced leverage and improved financial controls. While recovery was led by consumer demand, for the first time, exporting opportunities were considered more exciting and interesting than import substitution by many firms. In other words, not only has growth recovered quantitatively, but also qualitatively, which should allow gains to be sustained and expanded, albeit at a slightly slower pace.

Economic Growth (%)

1983	1.1	1986	2.0	1989(est)	5.6
1984	-7.1	1987	5.9		
1985	-4.1	1988	6.7		

The outlook is for growth to slow for the next one to two years to prevent an escalation of balance-of-payments or inflationary pressures. However, due to the structural reforms adopted since 1984 and to debt-induced disciplines, there should be no years of negative growth during the decade and growth rates should range from a low of 2% to a high of 7% with an average rate of 5-6%. While not the stratospheric rates enjoyed by other Southeast Asian countries in the 1970s, the stable growth rate should be sufficient to generate new investments and to support structural changes now underweigh without sparking an inflation/balance-of-payments crisis as in 1983. It should be noted that this forecast assumes a global economy free from significant crisis. Should there be a severe and sustained downturn in world growth and/or a steep jump in interest rates, the Filipino economy would be extremely vulnerable.

Inflation is not an endemic problem in the Philippines. There have been few occasions of double digit rates in the postwar period. The high rates of the early 1980s were due to a unique combination of prolonged political turmoil which curbed the effectiveness of government policies and to the severe debt crisis and loss of confidence. Unlike many other countries with high rates of inflation, the Philippines quickly reduced inflation without widespread resort to price and wage controls. It instead relied on temporary harsh monetary and fiscal policies and reformation of the financial system.

Inflation

1983	10.0	1985	23.1	1987	3.8
1984	50.8	1986	0.7	1988	8.7
				1989(est)	10.0

For the next one to two years, inflation will stay in the low double digits due to capacity limitations and demand pressures, as well as an expected acceleration in the depreciation of the peso. However, monetary discipline and gradual improvement of capacity should keep the decade average in the single digits.

The external accounts remain the most vulnerable point in the continuance of basic equilibrium in the Filipino economy. The balance of payments continues to be more volatile than desired, but the basics are improving and there are more safeguards against a crisis than in 1983.

External Accounts ($ million)

	1983	1984	1985	1986	1987	1988	1989e
Trade Balance	-2482	-679	-482	-202	-1017	-1085	-2210
Current Account	-2986	-1537	-200	971	-498	-373	-1600

Export performance since 1983 has improved consistently in volume terms. However, international price shifts have limited the impact on the trade balance. This constraint should be alleviated as capacity for new export production comes on stream.

The major cause of the trade balance deterioration is the enormous demand for capital imports being generated by the upgrading of capacity and quality. However, the liberalization of imports of consumer goods caused the too large deterioration in 1989. Undoubtedly, the drop in consumer demand will relieve the pressures this year, but the problem will remain if capacity of consumer goods production is not raised over the decade.

The external debt is approaching $30 billion this year. Unlike many other debtor countries, however, debt as a per centage of GDP and export servicing have fallen consistently since 1986. The country's management of its debt problems has been above the norm. This is an important point to remember as the government has sometimes been faulted for its management shortcomings regarding policy initiatives. The enormous time and effort spent on continual debt negotiations and satisfying its multitude of creditors by its key economic and financial officials often left little time for other considerations.

	1986	1987	1988	1989e
External Debt as % GDP	95	87	75	67
Servicing as % of exports of goods, services & income	337	327	275	242

The continuous monitoring of the external accounts by creditors whose approvals are needed for any additional loans will be the major bulwark against balance-of-payments deterioration cascading into another crisis. The insurance is necessary until the economy is restructured in ways which will strengthen the trade balance. Such restructuring is the basic objective of the resurgence in aid from the U.S. under the Multilateral Assistance Initiative and is the source of some of the best opportunities for American exports and investment.

Conclusion: The economy has been stabilized. Barring a major global problem, the economic fundamentals are headed in the right direction. This does not mean that there will not be difficulties in the economy over the next decade. It does mean that on purely economic grounds threats of slipping into economic crisis or of unpleasant and surprising changes in trends are very limited.

Implications for Investment.

Respectable growth will continue to generate new opportunities; stable growth will ease management.

Recurring inflation and/or balance-of-payments pressures will act to:

Keep upward pressure on wages, however, there is great scope for making offsetting productiviy gains and wages are below the norm for the region.

Interest rates high in real terms as the government relies on monetary policy as its major corrective. There is little potential for tax increases as the current non-payment of taxes is widespread. Price controls also have been ruled out.
However, the restructuring of the financial system (freeing it from political tampering) and the inflow of funds should act to prevent the credit squeezes of the late Marcos years. It should also be noted that smaller domestic firms which could act as suppliers still do not have access to reasonable credit. If the buying company does not arrange for or provide credit in sufficient amounts, there is a tendency for suppliers to save by cutting corners and reducing quality.

Keep downward pressure on the peso. An overvalued exchange rate and lagging correctives have been constants in postwar exchange rate policy. The heavily protected industrial structure which was dependent on foreign inputs and which primarily serves the domestic consumer market acted to constrain resort to devaluation. This continues to be true as industries interested in exporting must continue to import much of the capital equipment. Debt servicing also raise valid questions about the advisability of devaluation. The shift to greater export production should act to support a more realistic exchange rate, but calculation and forecasting of rates will remain one of the most critical elements of financial planning.

Limit stable accumulation of foreign exchange. While another debt crisis is not expected, the deteriorating trade balance coupled with the necessity of maintaining adequate foreign exchange reserves could cause access to reserves by companies to be limited. It is imperative that any investment address the issue of securing needed foreign exchange as there is no guarantee that the funds would be consistently available from official sources.

Issue: Investment Recovery. Will the current investment recovery strengthen, broaden and be sustained?

Although the debt crisis is usually taken as the most significant economic determinant in the Philippines, for most investors, the severe and decade-long downturn of investment by both the private and public sectors in virtually all areas of production and services is even more important. The most positive aspect of economic recovery sinces 1986 is the recovery of investment not only because it is so badly needed but also because, for the first time in many years, it is being led and sustained by the private sector. Even the resumption of infrastructure development is being done on a joint venture basis between the public sector and private interest, both foreign and local. This changing role of the private investor is as important as successful debt negotiations to the future of the economy. Indeed, for the potential American investor, it may be much more important as it not only signals an economy on the mend, but also promises better access and greater opportunities.

Real Gross Fixed Investment (% change)

1980	1981	1982	1983	1984	1985	1986	1987	1988	1989e
3	3	1	-3	-33	-24	-15	16	19	22

Major features of the investment recovery:

<u>The private sector-led recovery</u> is a departure from the Marcos years during which recoveries tended to be led and sustained by public sector investment, often funded by foreign loans. While much of the public sector investment improved infrastructure and helped the economy to adjust to the two oil price shocks, too much was tainted by corruption, including favored treatment of some private investors (the cronies) at the direct expense of others (e.g. using public power to force sales of businesses to Marcos supporters). All too often business success was more a function of political ties than acumen or skill. The efficiency of investment was further eroded by protectionist policies which tended to support less competitive import substitution and to undercut exporting efforts. Such policies weakened the competitiveness of Filipino industry and acted to isolate it from the dynamic progress in the rest of the region. Under the Aquino government conditions have improved markedly due to free market policies and the overall reduction of corruption from the egregious levels under Marcos. Corruption still exists but transparency of the democratic government and reduced funds are acting to limit the opportunities.

Public policy increasingly is moving away from state-led and planned development toward allowing and encouraging free market forces to act as determinants of investment. The movement often seems slow, but the direction is clear. Indeed, plans for infrastructure are being carried out by teams made up of private and public sectors. Some of the projects are identified by the private sector and will be matched with private sector investment. Much of the MAI funds are designated for such projects and it is U.S. policy to promote the participation of the American private sector.

Perhaps the best indicator of the rising commitment to the new policies is the limited effect of the recent coup attempt on the financial markets and planned investments (few have been canceled). As the economy becomes more free market oriented, political goodwill or adverse events are not as critical. Business is becoming less politicized and most firms are supportive of democracy (even if they are no longer as enthusiastic about the Aquino government). Political change is less frightening and is seen less as a zero sum game than in the days of Marcos when the government was flagrantly predatory in its relations with firms not closely tied to the regime.

<u>The sectoral breakdown</u> indicates that investment recovery is still tentative and susceptible to derailment. Most investment, thus far, has occurred in real estate, retailing and other services. Investment in manufacturing has been

31

limited in terms of larger-scale projects, but not insignificant or unimportant, e.g. large Taiwanese investment in petrochemicals, badly needed for backward integration.

There have been smaller scale investments in consumer goods, by large retailers and in export production, especially in electronics by foreigners.

Investment in manufacturing, in the near term, will be concentrated in export production and small and medium-size production for the local market, both consumer and industrial. There will be some investment in larger-scale backward integration, e.g. chemicals, textiles, but the industrial structure will tend to favor smaller firms (as in Taiwan) rather than the large, vertically integrated companies of Korea. The newer industries will be more a response to export than local demand.

The most active investors, thus far, have been those in the underground economy, local Chinese, and Asian investors.

The underground economy has expanded rapidly as it has in most indebted countries. Firms tend to be very small and generally only produce ancillary services or, to a lesser extent, primitive/small-scale manufacturing. There are many programs which are attempting to develop these firms into suppliers to industry. Any potential investor should consider using or participating in such a program as the industrial supply network is not highly developed.

The local Chinese, often allied to Overseas Chinese from Hong Kong, Taiwan and Singapore, have invested heavily in real estate, retailing, other services and some manufacturing, including exports, e.g. textiles and garments. Most of the investment is visible, but much is hidden e.g. services for Chinese businesses. Also ownership and financial details often are purposefully obscured. They rarely form partnerships outside the Chinese community, but it is interesting to track their activities as they tend to be the first to move to take advantage of new opportunities (e.g. Chinese traders are taking the most aggressive advantage of new opportunities from import liberalization) and are the first to reduce operations when conditions deteriorate.

Other Asian investment in manufacturing is more subdued, but appears to be inexorable. Hong Kong money is seeking a new haven and one which still has GSP with the U.S. It is primarily interested in investing in exporting to serve third country markets, particularly the U.S. Taiwanese investors, with the support of their government, are seeking to alleviate high wages and labor shortages at home and expand operations for its basic industries. Its investors will serve local, Taiwanese and third country markets.

The Koreans who have been favoring licensing agreements with limited manufacturing and investors from Singapore are actively looking. All of these investments will integrate the Philippine economy into regional growth and development as never before.

Japanese investors also are broadening their participation. They are investing in industrial estates and are expanding current investments and partnerships. They are primarily interested in investing for export and especially industrial inputs for supplier companies in Japan. They will use the Philippines as another spoke in their wheel of global enterprise. They also are investing in the local market in autos and steel. Of greatest importance, they are moving with greater speed than their American competitors and seem to see more clearly the strategic advantages of investment in the Philippines for global businesses.

Local Filipino firms are investing more, but, so far and quite correctly, the emphasis is more on upgrading and quality improvements than large expansions of capacity. Some firms, especially those with foreign partners, are expanding capacity, e.g. San Miquel with Coca Cola, but they are in the minority. Investing in exporting has the most momentum, but the starting base is low.

Americans and Europeans are lagging in terms of new investments or large expansions. While the U.S. in terms of total dollars remains the largest investor, the gap is narrowing. Investment in the Third world as a whole has declined and many American firms are more concerned with Europe, both the EEC and the East. However, American firms should ask themselves whether, through neglect, they are willing to lose their dominant position in the Philippines and allow competitors to monopolize the low-cost advantages of Filipino production. In addressing this question, it should be remembered that few firms have divested, even in the worst of times -- unlike other indebted countries.

Conclusion: The assertion of the private sector as the leading force in growth and development, the inflow of foreign investment and the pervasive realization of the need to improve competitiveness and exporting capabilities should undergird future investment. The degree of momentum, however, will depend critically on structural reforms now underweigh and planned as well as events in the political arena.

Political Issues

Issue: Structural Reforms. Are structural reforms working and will they support continued investment recovery?

The most difficult problem for the Philippines is that there are so many most difficult problems which are all being tackled at

39

once. Not only is the country attempting to change from a more dirigiste economy to one guided by market forces which implies a different role for government and changed behavior in the private sectors, both foreign and local; it also is trying to develop and sustain a democracy which demands participation by all segments of society. It is little wonder there are complaints or occasional disappointments when there is so much change being attempted.

To support the broad change to a market-led economy in a democratic state, a broad array of structural reforms have been considered. Some are well underweigh, others are more problematic and some seem to be stalled or even ignored.

The most successful reforms of interest to potential investors are the restructuring of the financial system and elimination of monopolies. The mismanagement and pillaging of major segments of the financial system brought it to the verge of collapse by 1984. A massive overhaul of the financial system to allow raising of new capital, to protect it from political entanglements and to improve allocation of resources on the basis of creditworthiness rather than political ties was the top priority in structural reform in 1984. It was matched by reform of the monetary authorities and both were able to develop new financial instruments to serve a more market-driven economy. The elimination of agrarian monopolies which were a major source of wealth for the cronies, was an early success. Both these reforms were a function of exposures made during the debt crisis and the fall of Marcos. In many cases, they had become important political issues and they were supported by external sources, e.g. AID, the World Bank.

There also are reforms underweigh which seek to raise the competitiveness of industry much of which has suffered from over-protection for decades. First, the Omnibus Investment Code which governs foreign investment was revised in 1987 ostensibly to improve promotion. However, it has been criticized by many for retaining too much regulation, for limiting promotional aspects and for too great a reliance on expensive incentives which exacerbate the chronic public deficit. As a consequence of such complaints, there has been a gradual cutting back of incentives (by making them available to fewer applicants) and proposals of eliminating the Board of Investments, the body within the Department of Trade and Industry responsible for promoting (and regulating) foreign investment. In any case, the important point about the Code is that many of its provisions are negotiable depending on the deemed value of the investment. The revision of the Code occurred in tandem with the beginnings of de-regulation which, unfortunately, often has been slowed by reluctant administrators. And finally, the cornerstone of the attempt to improve competitiveness, trade liberalization which was begun under Marcos, has had a moderate success, particularly in the capital goods and some consumer areas. However, and not surprisingly, there are products still protected and many of these represent businesses owned by top officials. It is still necessary for the new investor to check the lists for possible problems regarding inputs.

There are important reforms which are stalled:

-- agrarian reform which would be so critical for investment in agribusiness.

-- privatization which not only could present new opportunities, but which also could effect an entire sector if a major firm is on the block and progress is not achieved (there usually are few firms in a sector because of small market sizes and policies of restricting entry).

-- decentralization plans which could impact location decisions.

-- industrial sector restructuring plans are now two years behind schedule.

One of the most puzzling aspects of the Aquino government is the lack of new policy initiatives and the failure to pursue some of the reforms. Part of the explanation is that financial constraints and IMF supervision and demands have allowed only moderate departures from the austerity imposed in 1983-85. Part of the problem is the litigious nature of the Philippines -- a fact of life all too familiar to investors in the U.S.A. But part of the explanation has to lie in the competence of economic management which is the next issue to be addressed.

Conclusion: The reforms have made some progress, generally in those areas most easily influenced by external creditors. In other areas progress is much spottier and questionable and, therefore, their effects on investment are not certain. The investor would be wise not to accept reforms at face value. However, structural reform is by its very nature long-term in effect. The most important point is that the reforms are slowly creating conditions which can support a more competitive environment and which will create new opportunities.

Issue: Economic Management. Can the investor rely on the government to maintain a positive climate and to do the necessary in a timely, effective manner?

The content and style of economic management by the Aquino government has been dictated by four factors:

1. Re-establishment of democracy as the top political priority.
2. Promotion of the role of the private sector.
3. Financial Constraints.
4. Lack of Administrative Reform.

41

Re-establishment of democracy. Strengthening democracy has been the prime determinant of the style and form of management. The return to democracy has produced the normal attendant problems: slow decision-taking, public discord, frustration, grandstanding politicians, renunciations of the expediencies (and occasionally the effectiveness) of authoritarian rule. It also has the problems of a checks and balance system as well as those caused by the personal preference of President Aquino for government by consensus and conciliation rather than by dictate or confrontation. On the other hand, it is developing the strengths of a transparent, participatory system: emphasis on gaining the active cooperation and commitment of non-governmental groups and elites, checks against escalation of corrupt relations and transactions. The improved relations between the private sector and government which have resulted from the re-establishment of democracy and its norms meshes will with the ideals of a market and private sector-led economy and the gradual devoluton of decision taking and priority setting away from the public sector.

Promotion of the Role of the Private Sector. The non-Marcos private sector was instrumental in the overthrow of Marcos, the election of Aquino, and the re-establishment of democracy. It continues to be the most powerful, best organized interest group in the Philippines. Under Aquino, the private sector has taken over many of the roles of government either directly or by secondments/hiring of private sector people by the government (including heading some of the most critical Departments with power over investment). The private sector also is included in most decisions affecting it early in the process in highly structured and regularized meetings with government officials and administrators. It should be noted that some business people are leaving the government to re-attend to their businesses, but the relative power of business continues to grow.

Financial Constraints. There has been significant reform of public finances with programs funded by the World Bank, the IFC and AID. As a result, the growth of the public deficit has subsided and there is greater control of public expenditure. All departments are acutely aware of financial constraints and the very narrow margin for error. These realities are a major explanation for the lack of new policies as the constraints inhibit experimentation and risk. However, this very awareness also is acting to promote a wiser and more efficient usage of limited resources.

Lack of Administrative Reform. One way of describing the Aquino government as economic manager is a centralized system with no center. Marcos developed highly centralized systems of administration and governance to serve his dictates and actualize long-term plans, e.g. import liberalization. Under President Aquino, the system of authoritarian governance has changed to democratic rules and norms. However, the administrative system has not been re-organized -- only weakened by constant reductions of resources and frequent replacement of experienced technocrats with less experienced political appointees. The lack of reform is the overarching cause of delays and mistakes. Aquino's response to such problems, particularly slow implementation of policies, has been to form committees representing specific problems and sectors (e.g. power generation) which include representatives from all the affected parts of government and which can act fast and cut red tape. These committees report directly to the President's Office.

Conclusion. The Aquino record of economic management is far from perfect. The concentration on re-establishment of democracy, financial constraints, and periodic challenges from disaffected military rebels are partly responsible, but so are the failures to pursue administrative reform and to articulate a more specific and longer-term set of policies. Both policy making and implementation remain problematic, but they are improving and the outlook is considerably brighter given the MAI. All of the problems should be put in the context of the Aquino government's attempts to revive political and economic life after the Marcos debacles. The most important point to remember is that the government has taken no policies or actions which would hurt investment or discriminate against foreign investors -- quite the contrary. Also the track record shows some marked successes:

-- broadbased economic recovery
-- successful debt negotiations
-- reduced corruption
-- groundwork laid for industrial recovery
-- commitment to democracy
-- much stronger private sector capable of leading growth and development
-- improved public finances which will allow resumption of badly-needed infrastructure investment.

To sum up, the investor can rely on the government to maintain as positive a climate as it can given its financial constraints and the demands of democracy. It cannot always side with business, but it has shown a marked predispositon to do so and to fight vigorously against policies which would have an inimical effect. Congress is not as decisively committed, but its powers over investment are somewhat limited. Also when it has considered legislation affecting business, it has called for testimony from the private sector and it usually is given a fair hearing. The one word of warning about relations with Congress is that a potential advisor would do well to try to avoid asking for incentives which require the approval of Congress, e.g. relief from excise taxes or tariffs. Such approvals can become highly politicized and can take many months.

Investment for Local Markets

The greatest opportunities in the local market are:

-- Infrastructure development: the cutoff of aid during the the late Marcos years and the demands of fiscal austerity since 1983, severely reduced investment in infrastructure. The gradual improvement in public finances and the resumption of aid and multilateral lending have made infrastructure improvements possible. The enormous demand for and insufficient capacity and quality of current infrastructure have made them absolutely necessary. Transportation facilities, particularly inter-island shipping and railroads, need massive investments and organizational overhauls. The road system is inadequate. Power blackouts are becoming more frequent. Investment is needed not only in capacity but also in upgrades and rehabilitation. Telecommunications are far below standards needed for global businesses. And the Philippines, only now, is recognizing the need for better environmental programs. The country's future industrial development is increasingly a hostage to impoverished infrastructure. The problem is recognized and massive efforts are now underweigh to rectify the problems as quickly and efficiently as possible. As in the past, most of the financing will come from bilateral aid, including U.S. AID, and multilateral loans. Unlike the past, the loan and aid disbursement will be dependent on structural reforms to ensure the funds are not wasted. Also, and most importantly for American investors, the private sector is an integral part of the projects from the beginning. The Filipino private sector (with assists from foreign firms) are assessing and designing projects with the government. Private investors are encouraged to invest in these areas unlike the past, e.g. BOT's.

-- Industrial inputs: the industrial sectors badly need low-cost, high quality intermediate goods. Decades of protectionism have blocked development of backward linkages, e.g. poor quality paper has prevented devlopment of a printing industry which would be a natural export for this country given its high rates of literacy in English and low labor costs.

-- New consumer goods: this is a market of enormous unsatisfied demand with a marked preference for American goods (and fads). American companies which have invested here have had high rates of return (average 20-30%).

The major issues for such investment include:

Opportunity Assessment: It is not easy to assess the market. There is very little sectoral information of any depth and even less which is conducted on a regular basis. Firms have a marked distaste for sharing information with the government -- a partial holdover from the years of Marcos pillaging. Also the markets are small enough and with few enough members in a relatively restricted area (e.g. most production serving the local market is located in Metro Manila), that most believe they do not need data systems. In a sense they are correct. The potential investor can rely on his accountants (preferably one of the larger and well-connected firms) to introduce him to the market and to get him in touch with the most knowledgeable people. As in many countries, it is wise to be sceptical of data and announcements concerning investments.

Relationships: Relationships are always valuable, but in the Philippines they usually are critical. The business community is small and highly social. Business is conducted on a personalized basis and courtesy is expected and given. Displays of anger or impatience are always unacceptable. Loyalty is one of the most important values. Correct relationships can make or break an investment -- more so than in the U.S. One of the major reasons is that many laws and regulations can be negotiated, especially as so much of the system regarding investment is in flux.

For firms interested in joint ventures, there is a sizeable pool of potential partners. There are the well-established firms many of which have long experience in joint ventures. There are the newer entrepreneurs, e.g. people using family money to establish their own businesses, and the Asian investors now becoming established. A major advantage for an American investor is the fact that most Filipino firms would prefer an American partner because of cultural affinities and admiration for American managment and trainng techniques and technology. Also it should never be forgotten that most Filipinos have family members living in the U.S. or have been educated here.

There are several good sources of information on the business environment, but for the potential investor the two most critical are the publications of the Makati Business Club and of the Center for Research and Communication. An excellent monthly analysis is the Philippine Economic Newsletter.

Investment for Exporting

The Philippines is developing into an excellent location for exporting to the U.S. and third markets due to:

- -- U.S. GSP still extended
- -- lower labor costs
- -- leading role for the private sector
- -- export-oriented government policies and reforms.

Labor Costs: They are significantly lower than in other Asian countries to the point that Korea and Taiwan are investing for exporting from the Philippines. The outlook is for wages to remain competitive as Filipino firms are reluctant to raise wages because of the huge supply of labor. Wage increases which are given can be offset by productivity gains. National productivity rates tend to be low because of the low levels of investment in the past, but foreign users of Filipino labor have significantly higher productivity. Productivity and training are now top priorities and resources are being channeled to meet the need, both by the government and firms.

For several years after the debt crisis, there were many strikes, giving the Philippines the highest rate in Southeast Asia. However, the number of strikes has dropped sharply in the past two years. It also should be born in mind that neither labor nor management has had much experience with truly free collective bargaining. Under Marcos, labor disputes were often settled by the courts and labor lost many rights. Now collective bargainng is considered the major instrument to settle disputes; the Aquino government has removed government and the courts from the arena. It also should be noted that unions are too poor to sustain long, harmful strikes. In any case, an investor must invest in good collective bargaining skills.

Asian Competitors: As already has been noted, Asian investors are very active and many of them could use the Philippines as a base into the U.S. market, either directly as in the case of Hong Kong or Taiwan, or indirectly by lowering costs for home production as in the case of Japan. Particularly worrisome is the potential from the Koreans who are even more aggressive than the Japanese and who already have several licensing agreements with top Filipino firms.

Finally, there are many opportunities and options open to American investors. One of the most interesting is possible participation in industrial parks and export processing zones.

INVESTMENT CODES AND INCENTIVES

The Omnibus Investment code of 1987 (Executive Order No. 226) establishes the regulations regarding foreign investment in the Philippines. The basic formula for foreign investment allows up to 40% foreign participation in an enterprise without regulation. In November 1989 this limit was raised to 45% for companies listed on the stock exchange. In the case of less than 40% ownership (or 45%, if qualified), the only pro forma action that must be taken is to register at the Board of Investments (BOI).

Every investment which entails greater than 40% (or 45%) foreign participation in an enterprise must be approved by the Board of Investments. Approval is based on whether or not the firm is operating in an area determined to be "pioneer" by the annual Investment Priorities Plan (IPP), which is written by the BOI; whether or not the firm intends to export its products; and what percentage of production will be exported. If a firm in a pioneer area of production is not going to export 100% of its products, then after a certain period of time (30 to 40 years) at least 60% of the ownership must be turned over to Filipinos.

If the area of investment is not "pioneer", then approval is based on whether or not the area of investment is one which is not fully exploited by domestic companies; the activity is self-sustaining; the activity is not illegal; and it will not promote the formation of monopolies. If a company plans to export over 70% of output, and it is not in conflict with any of the above listed qualifications, then a non-pioneer firm may have greater than 40% foreign ownership.

There are Export Processing Zones in the Philippines in which many of the pioneer/non-pioneer and export/non-export qualifications and restrictions are waived. Philippine EPZs have successfully attracted foreign investment.

Table 1 provides illustration on the Philippine policy on foreign investment. Table 2 outlines sectoral restrictions on foreign investment participation.

Registering with the BOI and applying for investment incentives require a number of standard steps. The SGV 1988 report Doing Business in the Philippines, outlines these steps as follows:

- Submission of application for registration of the project and for access to incentives;
- Evaluation and approval of the application by the BOI; issuance of letter of approval; issuance of specific and general terms and conditions;

- Submission to and approval by the BOI of the request for advanced authority to import machinery and equipment and spare parts;

- Submission to and approval by the BOI of the request for advanced authority to import initial inventor (raw materials) and consumable (supplies) requirements;

- Compliance by the applicant with pre-registration requirements:

  Publication of a notice of approval once in a newspaper of general circulation and submission of the proof of such publication;

  Registration with the Securities and Exchange Commission (filing of Articles of Incorporation and By-Laws);

- Issuance by the BOI of the Certificate of Registration;

- Preparation and submission by the applicant of the application for tax- and duty-free importation od machinery and equipment; and

- Issuance by the BOI of a Certificate of Authority for the tax- and duty-free importation of capital equipment.

The Foreign Chambers of Commerce in the Philippines recently collaborated on an analysis of Philippine Investment Laws, suggesting means of making the Philippine investment climate more attractive to foreign investors. The paper encouraged a liberalization of investment codes, to allow easier access for outsiders to Philippine markets.

One of the items that the Chambers of Commerce suggested be changed is the 60:40 ratio of investment. As noted above, in November 1989 this ratio was relaxed to 55:45 for those firms listed on the stock exchange. This might increase employment opportunities for Filipinos and it should increase the attractiveness to foreign firms of investing in a broader spectrum of activities in the Philippines than is currently permissible. The Chambers of Commerce made a number of other recommendations, aimed at opening the Philippine markets and improving the signals that Philippines is indeed open to and actively encourages foreign investment.

The Philippine government is pursuing changes in the investment regulations for foreign firms; this should indeed enhance the attractiveness of the Philippine market for the foreign investor.

A synopsis of Philippine investment incentives is found on the following pages.

Investment Codes

Incentives

Fiscal incentives

Enterprises registered with the Board of Investments will be entitled to the following incentives:

1. **Income tax holiday**

New registered firms will be fully exempt from income taxes for six (6) years from commercial operation for pioneer firms and four (4) years for nonpioneer firms. This can be extended for another year in each of the following cases:

a. the project utilizes indigenous raw materials;
b. the project meets the prescribed ratio of capital equipment to number of workers set by the board;
c. the net foreign exchange savings or earnings amount to at least US$500,000 annually during the first three (3) years of operation.

Expanding firms will be entitled to an exemption from income taxes proportionate to their expansion for a period of three (3) years from commercial operation. They are, however, not entitled to additional deductions for incremental labor expenses during the period within which this incentive is availed of.

2. Additional deduction for labor expenses

   For the first five years from registration, a registered enterprise is allowed an additional deduction from taxable income of 50% of the wages corresponding to the direct labor, that is, the number of skilled and unskilled workers, if the project meets the prescribed ratio of capital equipment to number of workers set by the Board.

3. Tax- and duty-free importation of capital equipment

   Importations of machinery, equipment, and accompanying spare parts of new and expanding registered enterprises will be exempt to the extent of 100% of the customs duties and national internal revenue taxes. This incentive may be availed of within five years from the effectivity of the Code, or until August 12, 1992.

4. Tax credit on domestic capital equipment

   A tax credit equivalent to 100% of the national internal revenue taxes and customs duties that would have been waived on the machinery, equipment, and spare parts, had these items been imported by the registered enterprise which purchases such capital equipment from a domestic manufacturer. This incentive may be availed of within five years from the effectivity of the Code.

5. Exemption from contractor's tax, whether national or local.

6. Exemption from all taxes and duties on the importation of breeding stocks and genetic materials within 10 years from the date of registration or commercial operation of the enterprise.

7. Tax credit on domestic breeding stocks and genetic materials

   Within 10 years from the date of regisrration or commercial operation, a tax credit equivalent to 100% of the value of the national internal revenue taxes and customs duties that would have been waived on the breeding stocks and genetic materials had these items been imported by the registered enterprise which purchases the breeding stocks and genetic materials from a domestic producer.

8. Tax credit for taxes and duties on raw materials used in the manufacture, processing, or production of its export products and forming part thereof.

9. Access to bonded manufacturing/trading warehouse system

10. Exemption from taxes and duties on imported supplies and spare parts for consigned equipment.

11. Exemption from the wharfage dues and any export tax, duty, impost, and fee.

Nonfiscal incentives

1. Simplification of customs procedures

   Customs procedures for the importation of equipment, spare parts, raw materials, and supplies and the export of processed products will be simplified.

2. Unrestricted use of consigned equipment

   There will be no restrictions on the use of consigned equipment provided a reexport bond is posted, unless these equipment and spare parts were imported tax- and duty-free.

3. Employment of foreign nationals

   The employment of foreign nationals in supervisory, technical, or advisory positions for five (5) years from registration, extendible for limited periods, is allowed. The president, general manager, and treasurer – or their equivalents – of foreign-owned registered firms will not be subject to the foregoing limitations.

Additional Incentives

In addition to these incentives, the following incentives will be available to enterprises locating their operations in less developed areas:

1. Less-developed-area enterprises will be automatically entitled to pioneer incentives regardless of nationality.

2. 100% of the cost of necessary and major infrastructures and public facilities constructed can be deducted from taxable income. If the total amount cannot be deducted in one year, deductions may be carried over to subsequent years until the total amount has been deducted.

3. The rate of incentive for additional deduction for labor expenses will be doubled for enterprises located in less developed areas.

Additional incentives for EPZA-registered firms

Firms registered with the Export Processing Zone Authority will be entitled to all the incentives given to firms registered with the Board of Investments. In addition, they will be entitled to the following:

1. Special tax treatment of merchandise within the Zone

2. Exemption from local taxes (except real estate tax) and licenses

3. Exemption from real estate taxes on production equipment and machineries not attached to real estate.

Regional or Area Headquarters Incentives

Multinational companies establishing regional or area headquarters in the Philippines may be licensed to supervise their own affiliates, subsidiaries, or branches in the Asia-Pacific region. These regional or area headquarters and their expatriate executives will be entitled to the following incentives:

Expatriates

1. Multiple entry visa valid for one year and renewable annually provided that the foreign expatriate receives a salary of at least US$12,000 per annum

2. Withholding tax of 15% on gross income received from the regional or area headquarters

3. Tax- and duty-free importation of personal and household effects

4. Travel tax exemptions

Regional headquarters

1. Exemption from income tax

2. Exemption from contractor's tax

3. Exemption from all kinds of local licenses, fees, and dues

4. Tax- and duty-free importation of training and conference materials

5. Importation of motor vehicles for expatriate executives and their replacement every three (3) years provided the taxes and duties are paid upon importation

6. Exemption from the registration requirements of a foreign corporation doing business in the Philippines under Book II of the Code

7. Upon application with the Board of Investments, regional headquarters may establish regional warehouses to supply spare parts or manufactured components and raw materials to the Asia-Pacific region and other foreign markets in accordance with Book IV of the Code.

Offshore banking units

P.D. 1034 of September 1976 authorizes a foreign banking corporation to establish an Offshore Banking Unit (OBU) in the Philippines. OBUs must maintain net office funds of at least US$1,000,000. Incentives granted to OBUs include the following:

1. Foreign currency transactions with nonresidents of the Philippines and other OBUs are tax exempt;

   Foreign currency transactions with foreign currency deposit units, local commercial banks, and branches of foreign banks are also tax exempt; and

3. Interest on foreign currency loans to residents is subject to a final withholding tax of only 10%.

Incentives to foreign personnel of OBUs include the following:

1. Multiple-entry visa renewable annually;

2. Exemption from immigration fees and customs duties on personal effects, as provided in the Tariff and Customs Code; and

3. 15% withholding tax on gross income received from an OBU.

Other laws granting benefits to foreign and domestic investors

In addition to the foregoing benefits, corporations, partnerships, associations, or individuals may use certificates of indebtedness to pay the taxes arising from the construction of public works projects.

Investments in selected industries wit[illegible]

Following are the areas in which foreigners may invest but for which they cannot avail themselves of incentives:

Recruitment. Only Filipino-owned recruitment firms duly registered with the Philippine Overseas Employment Administration (POEA) may recruit laborers for overseas employment. Foreigners may invest in these recruitment firms only to the extent of 25% of the capital of the firm. On the other hand, foreign firms may contract a local recruitment firm to hire laborers for jobs abroad. In the case of construction personnel, only construction firms registered with the POEA and the Philippine Overseas Contractors Board may recruit laborers for jobs abroad.

Local construction. Generally, local construction projects are reserved for Filipino firms. However, foreign firms may obtain contracts for projects under the following conditions:

1. The construction project to be undertaken is awarded by the government through international public bidding;

2. The project is wholly or partially financed by such institutions as the Asian Development Bank, the World Bank, and the OECF;

3. The project will employ local personnel to the extent possible;

4. The foreign firm will team up with or subcontract certain phases of the project to capable local contractors;

5. The project will use locally produced construction materials, if these materials are of good quality and are sufficient in quantity and competitive in price.

6. The foreign firm conducts business in the Philippines only for the duration of a single contract.

In December 1986, President Aquino issued Executive Order No. 93 withdrawing all tax and duty incentives of government and private entities subject to certain exceptions. The withdrawal of tax and duty incentives does not apply to the following:

(a) Tax and duty incentives covered by the operation of the nonimpairment of obligation provision of the Constitution;

(b) Tax and duty incentives conferred by effective international agreements to which the Government of the Republic of the Philippines is a signatory. For this purpose, an effective international agreement is any agreement which is operationally binding upon and in force between the Government of the Republic of the Philippines and the other parties concerned;

(c) Tax and duty incentives enjoyed by enterprises registered with: the Board of Investments pursuant to Presidential Decree No. 1789, as amended; the Export Processing Zone Authority pursuant to Presidential Decree No. 66, as amended; and the Philippine Veterans Investment Development Corporation Industrial Authority pursuant to Presidential Decree No. 535, as amended;

(d) Suspension of taxes and duties due from the distressed copper mining industry pursuant to Letter of Instruction No. 1416;

(e) Tax and duty incentives conferred under the four basic codes: the National Internal Revenue Code, as amended; the Tariff and Customs Code, as amended; the Local Tax Code, as amended; and the Real Property Tax Code, as amended; and

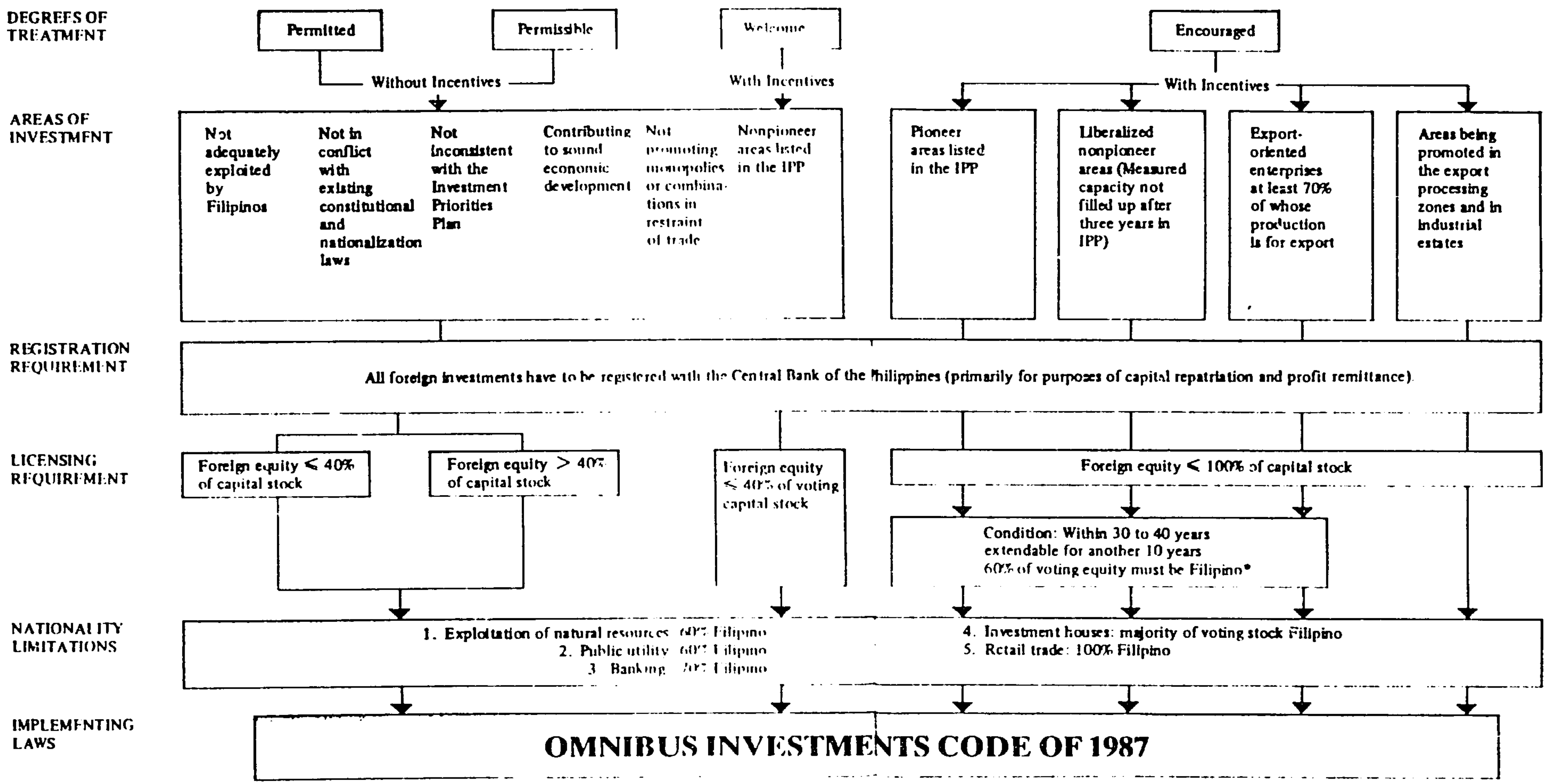
(f) Tax and duty incentives that may hereafter be approved by the President upon the recommendation of the Fiscal Incentives Review Board (FIRB).

Government and private entities whose tax and duty incentives are withdrawn may apply with the FIRB for the restoration of such incentives. The FIRB is empowered to restore, either in whole or in part, the tax and duty exemption or preferential tax treatment privilege of government and private entities. The FIRB may also grant subsidies in lieu of, or in combination with, the restoration of the incentives. The Secretary of Justice has, however, issued an opinion that the FIRB has no power to restore such exemptions or to grant subsidies.

Doing Business in the Philippines, The SGV Group, 1988.

TABLE 1

Philippine Policy on Foreign Investments



*This condition is waived in the case of producers exporting 100% of production.

LEGEND:
≤ Less than or equal to
> Greater than
IPP – Investment Priorities Plan

TABLE 2

NATIONALIZATION LAWS AND OTHER REQUIREMENTS

Subject Matter	Minimum Filipino Ownership Requirement (%)	Legal Basis
Banking		
Banking institutions (including private development banks)	70% of voting stock (60% with President's approval)	Republic Act (R.A.) 337, as amended by Presidential Decree (P.D.) 71, Batas Pambansa (B.P.) 61, B.P. 63, and P.D. 119
Rural banks	100%	R.A. 720, as amended by P.D. 122, P.D. 1794, and B.P. 65
Savings & loan associations, pawnshops	70% of voting stock except where a new association is established as a result of the consolidation of existing associations in which there are foreign-owned voting stocks at the time of consolidation	R.A. 3779, P.D. 113, P.D. 1796, and B.P. 62
Relending of foreign loans by government financial institutions	No requirement but capital stock, if not fully subscribed, must be open to subscription by the general public for projects authorized by the charters of government-owned or controlled financial institutions	R.A. 4860, P.D. 81
Public utilities		
Public utility	60%	Constitution (Sec. 11, Art. XII)
Domestic air commerce/ transportation	60%	R.A. 776
Finance institutions		
Financing companies	60%	R.A. 5980
Insurance business	No requirement	P.D. 612, as amended
Insurance companies	All directors must be Filipino	R.A. 2629
Investment houses	Majority of voting stock	P.D. 129
Government contracts		
Public works construction	75%	Commonwealth Act (C.A.) 541 (modified by R.A. 76)

Subject Matter	Minimum Filipino Ownership Requirement (%)	Legal Basis
Supplier to government corporations	60% unless there is a foreign law granting reciprocity	R.A. 5183
Supplier to government offices	75%	C.A. 138 (modified by R.A. 76 and amended by R.A. 6142 and P.D. 66)
Public works and construction for national defense	75%	C.A. 541
Mass media	100%	Constitution (Sec. 11(1), Art. XVI)
Private lands		
Transfer or assignment of private agricultural land	100%	Constitution (Sec. 7, Art. XII)
Public lands		
Disposition, exploitation, development, & utilization of agricultural, timber, & mineral lands and other lands of public domain; mineral, petroleum, & other natural resources	60%, subject to lease only (Note: Except for agricultural lands, all other lands of public domain are not alienable.)	Constitution (Sec. 2, Art. XII)
Lease of coal-bearing lands	60%	Public Act 2719
Disposition, exploitation, development, or utilization of minerals and mineral lands of the public domain	60%	C.A. 137, as amended by P.D. 463
Fishing and other aquatic rights		
Fishing operations	60%	P.D. 704
Retail trade		
Trading in rice & corn	100%	R.A. 3018
Retail trade business	100%	R.A. 1180
Cooperatives		
Cooperative associations	No requirement	P.D. 175
Geothermal energy		
Lease for exploitation, tapping, & utilization of geothermal energy, natural gas, & methane gas	60%	R.A. 5092
Coconut industry		
Coconut mills	Majority	R.A. 1369

SUMMARY SECTORAL ASSESSMENTS

AGRICULTURE

PHILIPPINE AGRICULTURE SECTOR

What are the primary agricultural commodities produced in the Philippines?

The major crops produced in the Philippines are, in order of importance, rice, coconuts, corn, and sugar; livestock and poultry are also important income generators. Fisheries make a significant contribution to the sector; prawns are taking on growing importance. Coconuts, sugar, and bananas are important foreign exchange earners for the economy.

Rice is the primary agricultural product of the Philippines. Estimated 1989 production levels are 5% higher than those of 1988, making it a record year. However, dry weather is predicted for 1990, which will limit the growth potential for the sector. In spite of 1989's record production levels, imports of rice were again necessary to meet consumer demand. In December 1989 rice was one of the six agricultural commodities that was targeted by government price controls. While price controls on the other five commodities were only effective in the Metro Manila area, those on rice were extended nation-wide. The controls are set to be lifted in June 1990.

Coconuts and coconut-related products are extremely important to the Philippine economy, both in terms of income and foreign revenue generated, and number of farmers employed in the sector. Coconut products produced and exported include copra, copra meal, coconut oil, coco-chemicals and fatty acids. Although prices for coconuts are forecast to decline in 1990, steadily increasing production will maintain the sector's stability. The dry weather forecast for 1990 will have an impact on coconut production only if it continues into 1991.

Corn is produced both as a domestic consumer good and as domestic livestock feed. The sector had been seeing strong growth for much of the 1980s; however, 1989 production levels were almost equal to those of 1988. The United States Foreign Agriculture Service attributes the slowdown in corn production largely to shifts by farmers into rice and sugar production, which are more profitable products. One of the main reasons for the low profitability of corn production is the lack of adequate transportation and marketing infrastructure in corn-producing areas, as well as a lack of post harvesting facilities. As in the rice sub-sector, corn production is likely to be adversely affected by the expected dry weather in 1990, leading to a further stagnation of the sector.

Sugarcane is a high value crop. Production in the sector has increased ever since its low levels in 1986/1987. The Sugar Regulatory Administration has forecast that production for 1989/1990 will increase by 6.9%, which is lower than 1988/1989's rise of 16.1%, but still adequate to supply both domestic and export markets. Prices in the sector have risen, however demand remains strong and exports have increased significantly in recent years.

While the **cattle and beef** industry has not fared well in recent years, **swine and poultry** have both expanded their outputs. Both industries have seen the introduction of modern production techniques in recent years, however, both have also seen a leveling off in consumer demand in mid-1989. As a result, it is likely that both sectors will undergo consolidation in the near future.

The **prawn** industry is a relatively new addition to the Philippine agriculture sector. Major varieties produced are giant black tiger prawns, white shrimp, and the banana prawn. The industry's first five years saw continued strong growth not only for prawns, but also for ancillary operations such as the feed and hatchery industries. However, falling demand from Japan, which has been the primary market for prawns, and increasing competition from new prawn producers in the Pacific region, will likely cause a consolidation of the sector.

What <u>role</u> does the agriculture sector play in the Philippine economy?

Forty-six percent of the Philippine working population is employed in the agriculture sector. Thirty-five percent of all manufacturing operations are food processors; this amounts to 30,000 establishments. Agriculture accounts for nearly one-quarter of GDP. Clearly the sector is a vital part of the economy of the Philippines.

In 1989 the agriculture sector's output value increased 4.8%. This is compared to a 3.2% rise in 1988 and a steady rate in 1987. The 1989 rise was a result of increased production, due to favorable weather conditions, and rising commodity prices - some crops saw a price rise of as much as 40% during the year. It is feared that dry weather in 1990 will again cause the output value of the sector to level off.

The average farm size in the Philippines is quite small - 2.6 hectares, according to the latest census in 1980. The implementation of the Comprehensive Agrarian Reform Program (CARP) in the coming years will further change the nature of land-holdings in the Philippines.

Development of the agriculture sector is currently stymied by the <u>lack of basic infrastructure</u> in rural areas. In particular, inadequate road systems in outlying areas prevent farmers from transporting their products to profitable urban markets. In addition, approximately 50% of the farms that need irrigation systems are without them. Also a number of products would reap greater profits if greater post-harvesting facilities were available. This is particularly true for corn.

If the sector is to continue to grow and play an important part of the economy, then investment in areas of necessary rural infrastructure is needed. The MAI/PAP expects to address this issue directly, through the establishment of Economic Development Zones (EDZs). In addition, a mini-consultative group is planned for the summer of 1990 to address issues of agricultural of reform; the agenda for this meeting has not been announced.

What government agencies act in the agriculture sector?

Agricultural Credit Policy Council - The ACPC was formed in December 1986. Its mandate is to ensure that adequate credit and finance is being supplied to rural development. Thus, its task is to create a policy environment conducive to such flows.

Department of Agriculture - The DA was formed under Executive Order 116, in January 1987. It comprises all of the former sub-sector agencies which dealt with agriculture. Its aim is to promote food security in the Philippines. The Secretary of Agriculture is **Senen Bacani.**

According to the United States Foreign Agricultural Service, the DA has the following functions:

- Creation of a policy environment conducive to increased incomes in agriculture;
- Production, verification, and dissemination of information relevant to agricultural productivity and development;
- Production, testing and dissemination of superior plant and animal germplasm;
- Facilitation of market access and promotion of agro-enterprises;
- Regulation;
- Implementation of empowerment programs; and
- Stabilization of supplies and prices of rice and corn.

The DA designs and implements agriculture sector development plans. The objective of the 1988-1992 plan is to increase the average farm family income to 2,000 Pesos per month by 1992.

Department of Agricultural Reform - The DAR is the main agency responsible for the implementation of the Comprehensive Agrarian Reform Program (CARP). The DAR has quasi-judicial powers with regard to the CARP's implementation. It may use these powers in presiding over decision making and dispute settlement pertaining to the CARP.

Beyond the ACPC, DA, and DAR, other agencies which act in the agriculture sector include:

- **The Department of Environment and Natural Resources** - Introducing environmentally sound and sustainable growing and harvesting methods in agriculture, aquaculture, and forestry;

- **The Department of Public Works and Highways** - Building and servicing rural roads and ports, so that farmers and fishermen can transport their products; and

- **The National Irrigation Agency** - Helping to provide irrigation technology to the sector. Approximately 50% of the Philippine farms that need irrigation are without it.

What is government policy affecting the agriculture sector?

Policy Overview

Recognizing the economic importance of agriculture, President Aquino has introduced economic development objectives which emphasize the development of the agro-industrial base of the economy and the rural areas of the country.

According to the Philippine Agenda for Sustained Growth and Development presented to the MAI/PAP donors in mid-1989, the primary aim of the government's agriculture policy is two-fold: first, to increase the real incomes of farmers and fishermen to above the poverty-line level by 1992; and second, to provide adequate food for the country's growing population. The government plans to pursue three principle policy goals with regard to agriculture: first, to remove unnecessary and costly interventions that have served as disincentives to producers; second, to improve farmers' access to land technology, irrigation and market infrastructure, and to provide employment opportunities for landless wage earners; and third, to rationalize government agencies in the agricultural and rural sectors.

Government expenditures on the agriculture sector in 1989 were Pesos 14.5 billion; this amounted to a 68% nominal increase over 1988's outlay of Pesos 8.7 billion. Government expenditures on the rural sector were Pesos 19.3 billion; this amounted to an 83% nominal increase from 1988's outlay of Pesos 10.5 billion.

Reform Programs

In keeping with the government's goals, one of the first reform steps undertaken by the Aquino administration was to dismantle the sugar, coconut, and fertilizer monopolies which had existed under the Marcos Administration. This allowed smaller farmers access to those sectors' markets. A number of other privatization and trade liberalization policies have directly affected the agriculture sector. However, the most noteworthy agriculture sector reform which is taking place under the Aquino government is the **Comprehensive Agrarian Reform Program.**[1]

The controversial CARP was legislated in 1988, as Republic Act

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[1] This section is drawn from discussion on the Comprehensive Agrarian Reform Program in the Foreign Agriculture Service's Annual Agricultural Situation Report - 1990; Section C.3.

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6657. The CARP aims to justly distribute a projected 10.3 million hectares of land to approximately three million farmers and workers in three phases, from 1988-1997. Landowner retention is limited to five hectares, with three hectares allowed for each working child of at least fifteen years old. The maximum amount of land that CARP beneficiaries may own is three hectares.

The Government will provide infrastructure and services to support CARP beneficiaries. Services to be provided will include:

- Credit
- Extension services
- Irrigation/post-harvest facilities
- Technical training
- Research and development

The cost of the scheme over its full life is estimated to be Pesos 403 billion. Support service activities take up the greater portion of the projected budget. The project will be financed by a variety of sources. Beneficiaries will compensate the government for the land that they receive over a period of 30 years at 6% interest.

The CARP will be implemented primarily by the DAR. Other participating government agencies include: the Department of Energy and Natural Resources, the Department of Public Works and Highways, the Department of Trade and Industry, and the Land Bank of the Philippines, which will receive the annual payments from CARP beneficiaries.

The CARP outlines four land transfer and three non-land transfer programs. Lands included in the transfer programs are:

- Tenanted rice and corn lands;
- Idle, abandoned, foreclosed, sequestered and voluntarily offered lands;
- Tenanted non-rice and non-corn lands and landed estates under labor administration; and
- Public alienable and disposable lands suitable for agriculture.

Non-land transfer programs are: production sharing, corporate stock transfer, and Integrated Social Forestry program areas.

Under Act 6657, public lands being used or managed by multinationals and foreign owners are to be redistributed over a period of three years, effective as soon as the Act was passed. There are a number of methods of redistribution: either direct distribution to farm workers, or a lease or growers contract between a cooperative of workers and the former employer, which does not necessitate dividing up the land inefficiently. 26,000 hectares of pineapple and palm oil lands owned by multinationals have already been transferred to farmers' cooperatives.

Ideally the CARP will induce the cultivation of more land than is presently used in the Philippines, by distributing idle or currently unused lands to farmers.

Livestock, poultry, and aquaculture producers have been the most active opponents of the CARP, fearing the eventual break-up of their farms under the programs land retention limits. Some of these firms have already been permitted by the DAR to use alternative methods of redistribution, including stock ownership.

While the CARP has already been passed into law, it is still a controversial piece of legislation, open to change and re-interpretation. The CARP reflects the Aquino government's desire to stabilize the rural areas of the Philippines and to equalize their status with the more modern urban areas. Improving the resources available to the agriculture sector is the only way in which this will be achieved. Under the MAI/PAP, the mini-Consultative Group on agrarian reform, to be held in the summer of 1990, is likely to address this issue.

Development Programs

At present, there are a number of active support programs in the agriculture sector. They include:

- Provision of technical assistance in aquaculture;
- Subsidy of fertilizer and seed cost under the Rice Production Enhance Program;
- Animal health services, provided by the DA;
- Price control, marketing, and trading of rice and corn, provided by the National Food Authority;
- Provision of seeds and planting material by the DAR;
- Breeding services;
- Government subsidized credit programs (See below); and
- Irrigation support.

The newest and most comprehensive agricultural development programs are in the Economic Development Zones targeted by the MAI/PAP. Both the Panay-Negros and the General Santos EDZs are specifically termed Agro-Industrial projects. Each focuses on developing the entire spectrum of services necessary to turn the zones into full service agro-industrial sights. The Samar Island EDZ also emphasizes the development of the agricultural sector.

Price Policy

In the wake of the December 1989 coup attempt President Aquino set price controls on six basic agricultural commodities in the

Manila area. The purpose of the controls was to prevent inflationary price surges and civilian stockpiling of certain foodstuffs. The controls are set to be lifted in June of 1990. Commodities covered by the controls are chicken, flour, milk, pork, rice, and sugar. Non-food items included in the controls are LPG gas and kerosene.

Only other price controls imposed by the GOP are non-retail. They are minimum support levels for the ex-farm prices of rice and corn, at Pesos 5.00 per kilo and Pesos 3.50 per kilo respectively.

Criticisms of Government Policy

Although President Aquino has attempted to reverse the anti-agriculture bias of development planning, her Government has come under criticism for inadequate attention to the needs of the agriculture sector. This criticism has come from sources as close to Aquino as the DA. According to the DA there are five areas of economic bias against the agriculture sector. They include:

- Trade Policies
- Government Expenditure Patterns
- Macroeconomic and Exchange Rate Policies
- Shipping and Transport Policies
- Taxation Policies

These biases damage the sector by decreasing investment incentives in the sector, maintaining a poor post-harvesting system, dampening potential agricultural productivity and competitivity, and decreasing the overall food supply.

Other criticisms have been recent charges that old sugar and coconut monopolies which existed under Marcos have not really broken up.

What <u>financial resources</u> are available to the agriculture sector?

As is true for many economic sectors of the Philippines, financial resources in agriculture are scarce; private investment is encouraged to provide necessary resources to the countryside, particularly in the form of post-harvesting facilities. Philippine farmers experience the same phenomena that occurs in accessing credit in the rural areas of many developing countries; in the banks' eyes, they simply do not have adequate collateral to secure a bank loan. Therefore, much of the rural lending takes place in the informal sector.

What government credit there is can be found in the **Comprehensive Agricultural Loan Fund** (CALF), under which the government will guarantee up to 85% of a banking loan to farmers. In addition to the CALF, agricultural loans may be financed via the GOP Agricultural Loan Fund which is financed by USAID and the World Bank. Interest rates range from 12% to 17%.

In addition, USAID and other donors run a number of agrarian support programs. These programs support a variety of aspects of agricultural production. USAID programs encourage policy reform, investments in infrastructure, development planning of local governments, and private sector participation in the rural sector. Total USAID portfolio value of assistance to the Philippine rural sector is $48.8 million.

<u>Private Sector Opportunities</u>

Given the nature of the CARP, land ownership for foreigners is not likely to be simple in the future; however, post-harvest opportunities are under-exploited in the Philippines, leaving a number of areas open to private sector investment. They are particularly appealing given the easy availability and low cost of inputs - both agricultural and human resource. Food processing for the export market is an area where open opportunities remain and it is worthwhile investigating others. Investment incentives exist in most areas.

ENERGY

PHILIPPINE ENERGY SECTOR

What is the status of supply and demand in the energy sector in the Philippines?

Supply

There are a number of different sources of energy in the Philippines, the main one being imported oil. Indigenous sources include domestic oil, geothermal, coal, hydropower, dendrothermal (wood burning), and non-conventional resources. According to the Office of Energy Affairs, in 1987 oil (domestic and imported) accounted for 45.2% of the generation mix in the Philippines. Hydro-generation accounted for 23.2%, geothermal contributed 20.0%, and coal and non-conventional contributed 9.9% and 1.7% respectively.

Domestic **oil** production peaked in 1979 at 8.57 million barrels. Between 1979 and 1988 new oil fields opened up, but production never attained 1979 levels. In 1988 the annual output was 2.25 million barrels. While there are new fields set to open, prospects for their production are not high; by 1991 production may fall to 500,000 barrels per year.

Development of **geothermal** resources began in 1972; commercial geothermal production began in 1979. The country is actively promoting the exploitation of geothermal sources. With the fall in international oil prices, geothermal electricity is the indigenous energy resource to develop in the Philippines. Reserves could exceed 8,000 MW, though only 1,640 MW are proven; 894 MW of capacity are active. The government decision to allow 100% foreign ownership of power generation concerns has opened the geothermal market to direct investment.

The Philippines has potential reserves of 10,000 MW of **hydro resources.** Hydropower development costs are relatively high compared to geothermal and other imported options.

An offshore **natural gas** reserve was found by Occidental in mid-1989. The size and quality of the find are unclear at this point.

While the government is encouraging and subsidizing the exploitation of Philippine **coal**, the quality of the product is low grade, and it is expensive to mine. Nonetheless, output has risen steadily since 1980 and is targeted to reach 4 million tons in 1991. There are 369 million tons of known reserves and 1.7 billion tons of potential reserves. Imported coal is used to fulfill quality requirements for some users.

Table 1 shows the incremental cost of power generation in the Philippines. This chart underscores the importance of geothermal power development in the Philippines.

Table 2 illustrates the power expansion plan of the Philippines, and the generating resources which will be used in new plants.

Demand

In order to decrease dependence on expensive oil imports, the Philippines introduced a program of energy conservation in the late 1970s. Energy demand peaked in 1979, at 9.2 million tons of oil equivalent (TOE) and fell to 7.1 million TOE in 1985. However, this downward trend reversed with the economic recovery that began in 1986; current predictions are that electricity demand will increase 5.4% per year from 1989 - 2000. It is forecast that the Luzon grid will be below demand by 500 gigawatthours (GWH) in 1989 and 1990; according to the US-ASEAN Center for Technology Exchange, by 1992 it is expected that the country will need an additional 1,950 - 2,000 MW of electricity to meet demand. (The government predicts that need will only be an additional 1,000 MW by 1993.) Contributing to this shortfall is the government's 1986 decision to prevent the opening of the 620 MW capacity Bataan nuclear power plant.

During the past year, frequent brown-outs have occurred in the Metro Manila area. The inability of power producers to meet growing demand now impedes the efficient functioning of many businesses and industrial concerns. Numerous industries including glass, oil refineries, rubber, iron and steel, cement, paint manufacturing, pharmaceutical, consumer products, chemicals and concrete, plastics, and semiconductors, have documented the declines in output that have occurred as a result of power losses. These calculations have given rise to accusations that the shortfall in energy supply is preventing continued economic recovery and growth. It is vital that investment occur in the energy sector, both updating existing facilities and creating new ones, so that supply and demand equilibrate. In addition, distribution networks must be extended, so that electricity reaches more than the current 50% of the population.

TABLE 1 **INCREMENTAL COST OF POWER GENERATION**

Option	Capacity	AIC (US¢/kWh)
Thermal:		
Imported coal	300 MW	3.46
Semirara coal	300 MW	4.50
Fuel oil	300 MW	4.32
Geothermal:		
Luzon geothermal	55 MW	2.90
Tongonan geothermal		
Alternating Current transmission	450 MW	2.72
Direct Current transmission	450 MW	3.10
Hydro:		
Pantay	23 MW	7.09
San Roque	390 MW	6.61
Casecnan	268 MW	5.54
Abra	174 MW	7.96
Diduyon	352 MW	5.83
BalogBalog	33 MW	9.74
Agos (Kaliwa)	140 MW	12.72
Matuno	180 MW	9.11
Gened	600 MW	9.69

TABLE 2 **LEAST-COST DEVELOPMENT PROGRAM**

Year	Plant	Capacity (MW)
1990	Combustion turbines	500
1992	Makban 7 geothermal	60
1992	Bacon Manito I geothermal	110
1992	Combustion turbine	200
1992	Bacon-Manito II geothermal	40
1992	Maibarara Geothermal	20
1993	Calaca II coal	300
1993	Luzon (Pinatubo/Natib) geothermal	120
1993	Calaca III coal	300
1994	Luzon geothermal	240
1995	Tongonan geothermal I (imported coal a/)	440
1996	Tongonan geothermal II (imported coal a/)	440
1997	Imported coal	2*300
1998	Imported coal	2*300
1999	Imported coal	2*300
2000	Coal (imported/domestic)	2*300

a/ Fall back alternatives which need to be prepared in the event that geothermal resources cannot be commited on time.

Source: The World Bank

Who are the major actors in the Philippine energy sector?

The regulatory environment in which the energy sector operates has been reorganized under President Aquino. The following are the primary agencies and companies involved in the Philippine energy sector:

- **Energy Coordinating Council** - The ECC was formed in September 1988 to address the difficulty inherent in the OEA's lack of authority to coordinate and carry out policies for the entire energy sector. The OEA is the ECC's secretariat. The ECC's membership includes the presidents of all sectoral organizations, as well as the Executive Director of the OEA. It is responsible for the annual preparation of a long-term energy development plan that is compatible with the National Economic Development Authority's (NEDA) plans.

- **Energy Regulatory Board** - The ERB was established in 1987. It is a quasi-judicial body responsible for the pricing policies of the energy sector. In addition it has jurisdiction over the capacity of refineries, the power rates of electric companies, and the issuance of certificates of operation for all public utilities. The ERB may regulate importing, exporting, shipping, transporting, processing, refining, marketing, and distribution of all energy resources. ERB staff also assure compliance with engineering specifications, product quality standards and instrument calibration.

- **Environmental Management Bureau** - The EMB is a branch of the Department of Environment and Natural Resources (DENR). The EMB monitors the environmental impact of the energy sector, including the disposal of toxic wastes, quality control for water, air, land, and noise, and the creation of environmental programs and policies affecting the energy sector.

- **MERALCO** - MERALCO is the largest privately owned electric utility in the Manila area.

- **National Electrification Administration** - The NEA is responsible for the promotion of Rural Electrification Cooperatives (RECs). There are now approximately 140 cooperatives in existence. The twenty year old NEA has run into a number of problems in its work, as its role has been ill-defined and the RECs have become politicized, decreasing the efficiency of their work. The World Bank recently completed an assessment of the Rural Electrification Sector. Reforms of the NEA and

RECs are being made based on the study's conclusions.

- **National Power Corporation** - State-owned NPC has primary responsibility for the development of Philippine Power grids and power generation. At the end of 1988, 88% of the total installed capacity of the power sub-sector belonged to NPC. NPC has oil, geothermal, hydro, and coal capacity. In 1988, NPC's facilities generated over 90% of the country's total power generation. NPC's operations are divided into three areas: Luzon and Mindanao, each with one grid, and Visayas, with five grids. The Luzon grid accounted for 76% of total energy sales in 1988; Mindanao accounted for 16% and Visayas, 8%.

- **Office of Energy Affairs** - The OEA was established in 1987 to replace the Ministry of Energy. Its Executive Director reports directly to President Aquino. OEA is responsible for formulating, planning, implementing, and coordinating policies and programs which will create an economically efficient Philippine energy sector. OEA plans and coordinates the activities of PNOC, NPC, NEA, ERB, and EMB; however, it has no authority over the actual actions of these offices and companies. It was for this reason that the ECC was formed.

- **Philippine National Oil Company** - The PNOC is a government-owned corporation, engaged in oil importing, refining, and marketing; hydrocarbon exploration; coal and geothermal resource development and exploitation. The company's main operations are its petroleum and geothermal sectors, which it plans to expand, according to its 1989-1993 development plans. The PNOC has a geothermal subsidiary , the PNOC-Energy Development Corporation (PNOC-EDC). PNOC-EDC has intensified its geothermal exploration and development activities in recent years.

How are <u>prices</u> determined in the Philippine energy sector?

In the past, energy prices have been set to reflect the average cost of supply. The government now plans to introduce pricing mechanisms which reflect the market price for all energy supplies, both at the wholesale and retail levels. The ERB is responsible for setting petroleum and privately owned electric utility rates. The NEA sets and monitors the rates for RECs.

MERALCO's rates are regulated by the ERB. They are based on the type of consumer: residential, commercial, or industrial. They do not account for the supply voltage level. Rates are based on a subsidized price scale for residential and small commercial consumers, although this scheme is being scaled back.

NPC sets its own bulk rates; however, they must be approved by the presidential cabinet. NPC's charter allows it to realize a net rate of return of 10% on its revalued net fixed assets. NPC's power rates are currently being restructured; in the future they will be determined using the long-run marginal cost approach.

The high price of energy in the Philippines puts industrial concerns at a comparative disadvantage. MERALCO has attempted to alleviate this problem in the Manila area by reducing its subsidy program to smaller users, so that it may charge lower prices to industry.

When geothermal steam is produced and supplied to NPC, prices are to be determined using the "avoided" cost method. The government is in the process of determining a mechanism that will allow geothermal producers to realize a satisfactory rate of return on their enterprises. According to the World Bank, this may come in the form of fiscal concessions, such as a royalty holiday for up to eight years from initiation of production.

What is Philippine government policy on private power development?

In January 1990 President Aquino outlined a five-year energy sector program "to develop a truly responsive energy program" in the Philippines. In a speech at the Energy '90 conference in Manila she said that the private sector would be encouraged to explore for new energy resources and to exploit those resources, with the assistance of the public sector.

Executive Order 215, passed in July 1987, **allows the private sector to build and operate power plants for their own use.** Excess electricity may be sold to NPC (See Appendix A, for purchase rates); both NPC and NEA may involve the private sector in power generation. The Executive Order indicates the government's recognition that outside resources are necessary to help the financially-limited energy sector develop (See the following section on Energy Sector Projects). These resources are particularly vital in light of President Aquino's decision in 1986 to scrap the 620 MW Bataan nuclear power plant; the increased demand for energy resources, generated by the economic recovery; and projections of a supply shortfall in 1989 and 1990.

The GOP decision to **permit 100% foreign ownership of power generation facilities** is meant to encourage cogeneration and direct investment in the energy sector by non-Philippine corporations, particularly in power generation and geothermal exploitation. Hopewell Holdings Limited of Hong Kong has pursued the construction of a 200 MW gas turbine power plant; the American firm Cogentrix is pursuing the development of a $340 million, 220 MW coal-fired Cogeneration project in Batangas.

The Hopewell project is the first **Build-Operate-Transfer (BOT)** project in the Philippines. As a result of the experience of implementing the Hopewell project, legislation has now been passed in the House of Representatives (House Bill No. 19440, June 5, 1989), streamlining the BOT process. Hopefully this bill will further encourage private sector participation in energy and other infrastructural sectors.

NPC has established rules of its own for private sector participation in its projects. These rules are added incentive for investment by the private sector: NPC assumes exchange rate and fuel price fluctuation risks. Investors only take the risk on project implementation and management.

In addition to supporting private sector involvement and competition in the power sector, the Government of the Philippines (GOP) policy encourages **diversification of energy resources.** This is to be done primarily by the development of the country's geothermal resources. According to Aquino's Energy '90 speech, it will also include the development of coal supply alternatives; the assessment and development of the viable hydro resources; the development of non-conventional energy resources.

Development of electricity generation capacity will emphasize geothermal resources, as well as coal and gas turbines; the government recognizes the need to rehabilitate and maintain existing power generating plants.

What <u>projects</u> are currently being pursued in the Philippine energy sector?

In recognition of the significant increase in demand for electricity in recent years, a number of new power generating projects are being planned. As noted above, emphasis will be placed on geothermal and coal-based generating facilities.

- In addition to the Hopewell and proposed Cogentrix projects, in 1991-1992, 170 MW of power is expected to be available in **Bacon-Manito**; this will be a geothermal facility.

- NPC has solicited interest in the 300 MW **Calaca** coal-fired plant and has short-listed twelve international companies, including Bechtel, K & M Associates and Applied Energy Services.

- PNOC-EDC is currently soliciting proposals for up to 60 MW of geothermal power from the **Mt. Pinatubo** and **Mt. Cagua** fields (See Appendix B).

- PNOC is inviting private companies to participate in joint-ventures, power which is generated in these ventures will be sold to NPC. Terms of the deal allow PNOC to have a 60% share of investment in geothermal development; the private company can maintain majority interest in the power generation investment. The detailed framework for these ventures, which will require an overall investment of $200-$250 million, will be available in June 1990.

- Under the MAI/PAP five economic development zones (EDZs) are being established. One of these, the **Calabar** region, includes a power development component, focusing on increased generation and transmission capacity. Sub-components include:

    - Construction of two generating plants with a combined capacity of 800 MW;

    - Construction of a 230 KV transmission line; and

    - Expansion of a number of the regions' sub-stations.

    It is in the Calabar region that the Cogentrix project is planned, as well as the expansion of the already existing Malaya power station by 500 MW. This program will be implemented by the NPC.

- In addition to the above programs, the private sector now has the right to investigate geothermal sites independently. As previously noted, the government is still working on the incentives and terms under which this may occur.

Energy

What <u>financial resources</u> are available to the Philippine energy sector?

As previously noted, it is due to the severe lack of public financial resources that the government is enthusiastically promoting the involvement of private companies in the energy sector. In the late 1970s public sector investment by the GOP was approximately 30% of GNP. Of this, energy consumed approximately 50% of expenditures. Today, energy sector investment is only 30% of what it was in 1979 real prices. Thus the government is making investment easier, establishing investment incentives and streamlining the BOT process.

In recent months the GOP has concluded negotiations with the World Bank and the Asian Development Bank on the two large power sector loans; the loans will fund major 1989-1992 NPC programs including geothermal development; inter-island transmission projects; maintenance of existing facilities; and small island power supply. The World Bank loan is for $390 million; the ADB loan is for $160 million.

Appendix A

REPUBLIKA NG PILIPINAS
Pambansang Korporasyon Sa Elektrisidad
(NATIONAL POWER CORPORATION)

NATIONAL POWER CORPORATION
Republic of the Philippines

NOTICE TO THE PUBLIC

Pursuant to Section 4, Article V, Part I of the Rules and Regulations on Private Sector Participation in Power Generation (Executive Order No. 215), the National Power Corporation (NAPOCOR) hereby discloses the following rates at which it shall make electricity purchases from Small Private Power Generating Facilities classified hereunder:

For the first block of 20,000 kilowatts of aggregate capacity within the Luzon power grid, with each generating unit not exceeding 5,000 kilowatts.

1. Firm and Dispatchable Power Type – where the capacity and energy is guaranteed by the proponent for a specified period of time and is subject to the dispatching system of NAPOCOR.

   Capacity Charge = $11.57/kW /mo. (p 260 /kW/mo.)
   Energy Charge = P 0.56/kWh, to be adjusted using actual purchases of NAPOCOR for its coal-fired thermal plants.

2. "As Available" and Dispatchable Type – where the capacity and energy is made available to NAPOCOR at the discretion ofthe proponent or on a seasonal basis but which output shall be subject to the dispatching system of NAPOCOR.

   Total Charge = 93% of NAPOCOR's Grid Selling Rate, to adjusted depending on the movement of NAPOCOR's selling rate.

3. Firm and "Must Run" Type – where the capacity and energy is guaranteed by the proponent for the specified period of ti me and which output msut be purchased by NAPOCOR.

   Total Charge = 90% of NAPOCOR's Grid Selling Rate, to be adjusted depending on the movement of NAPOCOR's selling rate.

4. "As Available" and "Must Run" Type – where the capacity and energy is made available to NAPOCOR at the discretion of the proponent or on a seasonal basis and which output must be purchased by NAPOCOR.

   Total Charge = 88% of NAPOCOR's Grid Selling Rate, to be adjusted depending on the movement of NAPOCOR's selling rate.

The above rates shall be reviewed by NAPOCOR every year or after each block of 20,000 kilowatts is reached, whichever is earlier.

(SGD.) E. M. ABOITIZ
President

Published in Phillipines Newspapers Jan. 24, 1990

Appendix B

Notice of Invitation

In the line with the Philippine Government's thrust towards encouraging private sector participation in energy development, the Philippine National Oil Company (PNOC) is inviting companies with demonstrated capability in the field of power plant construction and/or operation to enter into joint venture agreement for steamfield development and power plant construction in the geothermal fields situated at Mt. Pinatubo, Zambales and Mt. Cagua, Cagayan. The electricity generated by the power plants shall be sold to the National Power Corporation.

The estimated power-generating potential from the above fields is in the order of about 60 MW each. Exploration drilling of three (3) wells has been completed in Mt. Pinatubo.

The extent of private sector participation shall be as follows:

Steamfield development project - up to 40%
Power plant project - up to 90%

Four (4) contracts/agreement will be necessary:

1. Joint venture for steamfield development project.
2. Joint venture for power plant project.
3. Steam sales agreement between steamfield developer and power plant company.
4. Electricity sales agreement between power plant company and National Power Corporation.

Interested companies should be willing to be party to both steamfield and power plant project joint ventures. Participant in either steamfield or power plant projects only shall not be entertained.

Expression of interest, which shall include company profile and testimonial attesting to eligibility to undertake the work, should be submitted not later than February 28, 1990 to the following address:

PNOC Energy Development Corporation
C/O Mr. Samson P. Javellana
Merritt Road, Fort Bonifacio
Makati, Metro Manila
Philippines

For further details, Mr. Javellana can be contacted through Fax # (632) 815-27-47 or at telephone (632) 815-89-61

ENVIRONMENT

THE PHILIPPINE ENVIRONMENT AND NATURAL RESOURCES

What is the current state of the environment and natural resource supplies in the Philippines?

The Philippines is fighting a battle between the priorities of economic development versus the exigencies environmental degradation. Over the years, exploitation of natural resources has been a means of economic growth; however, it is now recognized that if this exploitation continues without attention paid to its consequences, the Philippines risks destroying its basic tools of development. The following is brief synopsis of the status of various areas of environmental concern:

Agriculture: According to a recent USAID assessment of the Philippines' natural resources, the agriculture sector is in a position of sustainable growth. However, growth cannot come in the form of increased land use; rather, new production techniques might permit more intensive production of certain crops, particularly rice and corn. These techniques must perpetuate the sustainability of the land, by implementing proper rotation and planting methods, so that soil quality is maintained, and erosion is prevented. They should also promote the use of organic fertilizers which will decrease water pollution. It is hoped that the introduction of land ownership under the CARP will provide farmers with the incentive to make environmentally sound use of the land.

Coastal Areas: As the population of the Philippines has risen, pressure on costal areas has increased. Fishing is a common livelihood; it is a difficult task to convince the fishermen that fish are a depletable resource.

Dynamite blasting of coral reefs and other destructive fishing methods have severely damaged the Philippines' marine fish habitats; waste from industrial areas is often dumped directly into the ocean, further damaging fish habitats. In addition, forest erosion causes siltation, which eventually ends up in the coral reefs.

The problems facing the costal areas are severe; they threaten not only the integrity of important natural resources, but also the livelihood of a significant proportion of the population. For this reason any solutions will have to account for the economic and environmental impact of reform. New, environmentally sound fishing techniques must be adopted, if coastal areas are to remain healthy.

Energy: The Philippines is dependent on imported oil for a large portion of its energy supply. Ever since the oil crisis of the 1970s the government has promoted energy self-reliance. At present the main thrust of the energy policy is the promotion of indigenous geothermal and coal resources. Encouragement of the use of wood-burning plants has slowed, due to problems with severe deforestation (See Forestry). In addition, in an attempt to promote non-harmful forms of energy supply, the government is in favor of the development of non-conventional resources, such recycling of waste products, windmills and solar collectors.

Forestry: The rapid rate of deforestation is the most serious environmental threat facing the Philippines. Land in the Philippines has two classifications: (1) Alienable and Disposable and (2) Forest. Approximately 50% of the land is classified as forest; however, of the 15 million hectares of forest land, only 6 million actually have forest cover. It is estimated that at one time, there may have been as many as 20 million hectares of forest cover in the Philippines.

According to the Department of Environment and Natural Resources (DENR), illegal logging and deforestation deprive the country of an additional 210,000 hectares of forest per year. Due to conversion to fishponds, acreage of mangroves has fallen from 500,000 hectares in the 1920s to less than 38,000 hectares today, according to the DENR. Deforestation is not only a problem in its own right, but also contributes to serious soil erosion and siltation problems, which ultimately are harming the ecosystems of the Philippines' coral reefs.

Population pressures are likely to continue to force migration into uplands where much of the forest growth is located. As in the agriculture sector, the lack of property ownership in upland areas is a disincentive for those in the area to conserve forest resources, and as in the costal areas, any reform programs must consider not only environmental issues, but also the economic and employment issues which drive the populace into these areas to live and work.

Urban Centers: The urban centers of the Philippines, particularly Metro Manila, face the environmental problems that are common to every major city of the world: Lack of solid waste management facilities, toxic and hazardous wastes, air and water pollution. A constantly increasing population is not likely to help these problems disappear, and it will take concerted effort and management to effectively bring them under control.

What government agencies are involved in environmental planning and regulation?

Department of Energy and Natural Resources - The DENR was created in June 1987 under Executive Order Number 192. Under this legislation, the DENR was given a mandate to formulate a strategy for sustainable development. The Philippine Strategy for Sustainable Development (PSSD) was formally created in the fall of 1989.

In addition to the mandate to develop the PSSD, the DENR is responsible for the management of public lands, primarily forests and mangrove areas. Ultimately Regional Environment and Natural Resource Offices will be created, in order to decentralize the functioning of the DENR.

There are six staff bureaus for the DENR:

- Forest Management Bureau
- Land Management Bureau
- Mines and Geo-Sciences Bureau
- Environmental Management Bureau
- Ecosystem Research and Development Bureau
- Protected Areas and Wildlife Bureau

Several agencies report to the Secretary of the DENR. They are:

- The Pollution Adjudication Board
- National Mapping and Resource Information Authority
- Natural Resources Development Corporation
- National Electrification Agency

The DENR is currently in the processing of streamlining, with the aim of creating an image of an effective development agency, rather than one of a corrupt regulator.

Department of Agriculture - The DA's Bureau of Fisheries and Aquatic Resources works directly with issues affecting the costal areas. Given its policy making nature, the DA is also in a position to promote environmentally responsible farming techniques that generate farm income.

Department of Agricultural Reform - The DAR is the agency responsible for the implementation of the Comprehensive Agrarian Reform Program (CARP). It is envisioned that the redistribution of land to be carried out under the CARP will positively affect the environmental status of the uplands: farmers will become landowners and will therefore be given incentive to maintain the healthy productive capacity of the lands on which they work.

Local Governments - While local governments are, for the most part, ineffective managers of their respective regions' resources, they are the logical candidates for such a role. They have been given such a mandate by the Government of the Philippines. Whether or not they can raise the capital and the initiative to carry out this role remains to be seen.

Environment

What is the Government of the Philippines' <u>policy</u> on the environment and natural resources?

The 1986 constitution of the Philippines specifically recognizes and underscores the need to manage the country's environment and natural resources. In this light, as noted above, the GOP created the DENR in mid-1987, to develop a strategy for sustainable growth, to regulate the natural resource use in the Philippines, and to manage the public lands. A primary step towards the effective management of the environment was taken by the development of a **Philippine Strategy** for Sustainable **Development** (PSSD) in late 1989. The PSSD sums up the objectives and goals of Philippine environmental policy, in the context of economic development.

The primary goal of the PSSD is <u>to achieve and maintain economic growth without depleting the stock of natural resources and degrading environmental quality</u>.

Objectives of the PSSD are:

> To ensure a sustainable utilization of the country's natural resources such as forests, croplands, mineral and marine and freshwater ecosystems.
>
> To achieve and maintain an acceptable quality of common resources such as air and water.
>
> To maintain the country's species and genetic diversity.
>
> To ensure the integrity of essential ecological processes and life-support systems.
>
> To achieve a level of population growth that could be optimally supported by and would not cause undue stress on the country's resources.

The PSSD identifies a number of strategies that it will use to achieve its objectives and goals. Among others, these include actions such as incorporating environmental concerns into all areas of decision making; environmental education; citizen mobilization; introducing correct pricing mechanisms for natural resources; pollution control; and population control. Ideally sectoral strategies will be formed by sectoral working groups and the PSSD will be fully implemented and in the monitoring stages by 1995.

While the PSSD is still in the theoretical stages, it does indicate the GOP's awareness of the environmental and natural resource issues facing the country. If effectively put into action, it should initiate policies which will help to save and sustain the Philippines' natural resource base. However, basic problems of educating the public to understand the necessity of conservation, and obtaining adequate financing for the program do present serious challenges to its potential effectiveness.

According to the DENR, actual resource conservation policies and regulations that have been made in recent years include:

- Total ban on log and lumber exports;
- Total log ban on selected areas;
- Guidelines reducing the allowable cuts of Existing Timber License Agreements;
- Guidelines for the implementation of Timber Production and Mineral Production Sharing Agreements;
- Guidelines promoting community based forest management;
- Agreement in principle to the proposed measure of total or selective log ban in the remining old growth forests;
- Shift from reforestation by administration to reforestation through contracting of private corporations, NGOs, local governments, communities and individual families;
- Active involvement of the private sector and private citizens in pollution control and environmental monitoring.

In addition, environmental consideration is being made in the development of the five Economic Development Zones (EDZs) which are being funded under the MAI/PAP. Those which encourage the development of an agricultural economic base promote the use of sustainable farming techniques; those which promote industrial components do so with an eye towards using environmentally sound technology.

Other Sources of Activity in the Sector

The government actively encourages the involvement of the private sector in conservation and environmental quality control, particularly in areas which require the introduction of new technology, such as solid waste management; air pollution and water pollution control; rebuilding of coral reefs; and sustainable farming and logging techniques.

A consultative group on environmental policy is to be held between the GOP and MAI/PAP donors in 1990. Donors have actively financed environmental conservation projects in all sectors of the Philippine economy. Both the World Bank and USAID have recently concluded assessments of the status of Philippine natural resources; each expresses concern about the rapid rate of resource depletion. As concern continues to rise, it is likely that donors will continue to fund environmental projects in the Philippines.

FINANCE

THE PHILIPPINE FINANCIAL SECTOR

[Also see section on the Philippine Investment Climate]

What is the status of the Philippine financial system?

Banking

The 1980s were a decade of crisis and restructuring in the Philippine banking system. Between 1980 and 1987, banks holding a total of 2% of the system's assets failed. In addition, two government-owned commercial banks became insolvent: the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP). They were bailed out by the selling of non-performing assets to the Asset Privatization Trust.

Philippine banks are relatively small and the Central Bank of the Philippines (CBP) has encouraged mergers between banks, in order to create healthy competition and stability in the system. The CBP has used a number of incentives to promote this, including allowing banks to act as a universal bank - both a commercial bank and a security house - if they have a net worth that is greater than P1 billion.

The base line for being a universal bank was P500 million up until November 1989, when the CBP raised the minimum, in order to solidify the banking system's capital base. Banks have 12 months to raise their capital bases up to the new minimum. Foreign banks operating in the Philippines are not allowed to operate as universal banks. In November 1989 non-universal banks were also required to raise their capital base, from the previous P300 million floor to P500 million over the next 12 months.

In December 1976 offshore banking and a foreign currency deposit system were established in the Philippines. Offshore Banking Units (OBUs) are allowed to buy 30% of a local bank, however they are not allowed to participate in the lending of pesos. OBUs may buy 40% of a local bank with the approval of President Aquino.

The Philippine banking sector's profitability has increased during the latter half of the 1980s; the once faltering PNB is now the Philippines' third most profitable enterprise. Interest rates have remained positive recently, encouraging more deposits. They are expected to remain positive for the foreseeable future, which should continue to promote capital growth and profits.
However, there are still a number of areas of potential reform which remain within the system. These have been identified by several sources, including the World Bank; the government is said to be considering means of changing them. Three of the most important are:

- High financial intermediation costs
- Lack of long-term credit
- Restrictions on the opening of bank branches

These restrictions block the flow of credit and the growth of the Philippine capital base. However, not withstanding these factors, the Philippine banking system is slowly emerging in surprisingly healthy form from a serious crisis.

It is likely that the government will be instituting reforms in the system in the coming months, as President Aquino continues to promote private sector participation in the Philippines' economic recovery. Most outside observers still point to changes that can be made to streamline and stabilize the banking system, but they also agree that the system is on the road to recovery.

Securities

The Securities and Exchange Commission is the government's supervisory agency for the securities industry. It was formed in 1936, and is governed by laws which designate its role as a protector of investors. The SEC also registers companies and settles disputes between corporations.

The stock exchanges in the Philippines are relatively low in activity. According to the Far East Economic Review, of the 137 firms which are listed on the exchanges, only about 35 of them are of significant interest to investors. The Philippine government has recently attempted to change this situation, by allowing foreign investors up to 45% participation in a firm, without Board of Investment approval, if the firm is listed on the stock exchange. It is hoped that this will promote the listing of a wider range of strong, active stocks on the market. In addition, there have been several profitable offerings in the past year, including the privatization of PNB. It is hoped that the success of these offerings will stir interest in the stock exchange, as well as in the government's privatization program.

In September 1989 the Chinese-Filipino businessman, John Gokongwei, listed 40% of the equity of his company, Robinson Land Corporation, on the exchange. The offering was expected to raise at least P1.1 billion. The revenues will be used to finance the firm's P2.2 billion project building a commercial hotel-condominium project in Metro Manila.

The offering was the first move by Gokongwei to open his family run business to outside investment. Because the issue was successful, it is hoped that it will stimulate other family-owned and operated businesses to take advantage of the stock exchange's potential capital, thereby naturally widening the base of the stock market. Other successful offerings in late 1989 included

25% of Integrated Chrome corporation's equity and P137 billion worth of Philippine Telegraph and Telephone.
The $60 million First Philippine Fund, which was launched in New York in November 1989, has been very successful. Two more funds are currently being planned for London and tokyo. The funds raised by the issues, will be used to invest in the Philippines Stock Exchange.

There are two types of stocks offered on the Filipino exchange. Class A stocks are limited to Filipino investors, and class B are open to foreigners. Companies often split their offerings between the two classes of stock.

The Philippine financial system is likely to change and develop in the coming months. The government recognizes capital's role in the successful involvement of the private sector in the growth of the Philippine economy and is likely to take steps to facilitate the use of banking and financial resources by the private sector.

TELECOMMUNICATIONS

PHILIPPINE TELECOMMUNICATIONS SECTOR

What is the present status of the Philippine telecommunications sector?

As is true of the majority of the countries in the ASEAN region, the Philippines' telecommunications networks are concentrated in the nation's urban regions. Unlike other countries in the region, however, most of the services in existence are privately owned and operated. In general, the government serves only as a utility regulatory body.

The Philippines has a density of 1.04 telephones per 100 people. While Manila only accounts for 12.7% of the country's population, over 70% of the telephones are in the Metro Manila area, where there are 5.73 phones per 100 people. The main Philippine telephone company, with over 90% of the market share and 94% of the telephone lines, is the **Philippine Long Distance Telephone Company** (PLDT), which has been in existence since 1905. PLDT is privately owned. There are 55 other private telephone companies in the country.

There are **seven domestic record carriers**; four major private sector companies offer the standard services of **international record carriers**: telex, facsimile, press bulletin, and Datel. The international companies are Eastern Telecommunications Philippines, Inc. (ETPI), Philippine Global Communications (PGC), Globe-Mackay Cable and Radio Corporation (GMCR), and Capitol Wireless, Inc. (Capwire). A number of these companies have significant foreign participation in their ownership.

There are two companies which provide **satellite** services. **PHILCOMSAT** has been linked to INTELSAT since 1966 and to INMARSAT since in 1981. These two networks allow PHILCOMSAT to operate voice/record/data circuits with over thirty countries. **DOMSAT** is the domestic satellite network, which has 12 stations spread across the country. It has been having financial difficulties recently, which may jeopardize some or all of its services.

The government operates its own telecommunications network through **Telof** (Telecommunications Office - previously Butel) a division of the Department of Transportation and Communications (DOTC). Telof is a domestic voice and records carrier for the government. In certain rural areas that are not linked up to any telecommunications networks, Telof acts as a telegraph transmitter.

Manila is slowly gaining **paging** services; one is currently functioning, and others are in the planning stages. In addition, the National Telecommunications Commission (NTC) has received an application from a firm wishing to set up an **electronic mail** service between the U.S. and the Philippines.

From 1985 to 1987 the **market for telecommunications equipment** and services was poor. During that period gross revenues in the sector fell from US $58.6 million to US $54.2 million. However, the economic turnaround of 1986 has affected the telecommunications sector and the market is now improving. The GOP projects that purchases of telecommunications equipment will reach $381.5 million by 1993. Growth sectors, as identified by the United States Department of Commerce, include:

- Phone/Telex/Telegraph equipment;
- Transmission equipment;
- Data communications equipment; and
- Mobile radios, video, and radio broadcasting equipment.

Domestic production of these items is expected to almost double by 1993, aiming for an increase from 1988's US $18.6 million to US $30.5 million. There is no domestic production of data communications equipment. Again according to the US Department of Commerce, this is due to the high initial cost of investment and the state-of-the-art nature of the equipment.

What government agencies affect the telecommunications sector?

Department of Transportation and Communications - The DOTC is the representative of the executive branch of the government responsible for developing and implementing policies affecting the Telecommunications sector. It was formed in 1979. Programs developed by the DOTC must correspond with the priorities of National Economic Development Authority's (NEDA) development plans, as well as Congressional priorities for the sector.

> **National Telecommunications Commission.** The NTC is under the auspices of the DOTC; it acts as the regulatory arm of the DOTC. It has a Legal Department and a Telecommunications Planning and Development Department. Applications from companies wishing to establish telecommunications services or franchises are reviewed by the NTC. As is true of the United States' FCC, after which it was modeled, the NTC has regulatory and enforcement powers over the functioning of entities within the telecommunications sector. Given government frustration with what it perceives as a private sector that is unresponsive to economic development and rural regions' needs, the regulatory functions of the NTC are likely to be upgraded in the near future.

National Telecommunications Development Committee - Created in 1988, the NTDC is responsible for pinpointing primary issues affecting the functioning of the telecommunications sector. It also acts as a mediator between policy formulators and the private sector, in the case of disputes. Under the auspices of the NTDC the main actors in the Philippine telecommunications sector have discussed a sectoral restructuring. Options for a new structure range from total monopoly to complete open market.

Philippine Congress - In the telecommunications sector the Philippine Congress plays a role developing legislation which affects the sector. DOTC has to coordinate its policies and guidelines with those of the Congress, so that there are no conflicting rules or interests affecting the sector.

What is government policy on the Philippine telecommunications sector?

As noted above, the Philippine Telecommunications sector is largely privately owned. The government's role in the sector is a regulatory one. However, the government feels that the private sector has been unresponsive to users' needs in the telecommunications sector. Recognizing the dichotomy between telecommunications services available in the urban and rural regions, the government has committed itself to the provision of telephone services to the rural sector; it has consequently developed a **National Telecommunications Development Program** (NTDP). The telecommunications facilities built by the government under this project can be leased out for operation by private companies.

Briefly, the main components of the **National Telephone Project** (NTP) are as follows:

- The entire plan aims to install **380,000 new telephone lines,** during the entire life of the project. There are currently 750,000 lines in the Philippines.

- The **first phase** of the project will install **138,000 lines** in 85 different municipalities. The Japanese, the French, and the Italians will be the implementors.

- The first phase is expected to be complete by the end of 1990. It is budgeted for US $369 million, to be provided by the World Bank, local credit institutions, and stock issuance.

Washington, D.C.-based Teleconsult International and Manila-based SGV Group worked together to develop the most efficient and economical means of putting the NTP into action.

In addition to the NTP there is also a rural development project called the **Municipal Telephone Project** (MTP).

- Ultimately, the aim of MTP is to provide every municipality with at least one public phone and to raise the national phone density from 1.04 to 1.9 by 1995. Total cost is expected to be US $83 million.

In association with the MAI/PAP, and in keeping with the government's desire to develop the rural telecommunications infrastructure, the government will support the development the communications capabilities in four out of the five **EDZs** which are currently in the making.

- In **Panay-Negros**, 3,000 new lines will be installed in Iloilo City, Oton, and Pavia. DOTC will introduce new switching equipment, outside plant equipment, and transmission spur.

- In **General Santos City**, which is located at the southernmost tip of the Philippines, communications capabilities are essential. The DOTC is including General Santos City as one of the pilot areas for digital telephone system installation, which will introduce 1,100 new lines into the area. [It is possible that this will be cancelled.]

- **Cagayan de Oro** will be affected by the introduction of a digital telephone backbone and the installation of 43,900 digital subscriber lines in the Mindanao region under the NTP. Cagayan de Oro City will actually receive 11,000 of these lines. In addition PLDT will introduce 1,100 line in Region X where Cagayan de Oro is located. These lines will be installed by 1993.

- The **Calabar** project will also upgrade telecommunications facilities in its region. Under the NTP and PLDT's X-5 project Calabar aims to have an additional 44,850 lines by 1993. This will more than double the number of lines in the region.

Finally, in the <u>private sector</u>, PLDT has an expansion program in the works entitled **X-5**. Under X-5 PLDT expects to add 355,000 lines to its system at a cost of $600,000. Siemens will be responsible for 180,000 lines, the others are still open to bidding.

What resources are available to finance Philippine telecommunications projects?

As with the agriculture and the energy sectors, lack of financial resources is a key stopping point for any Philippine telecommunications projects. As in the other sectors, the Government encourages outside private investment in the telecommunications sector and appeals to international development organizations for sector specific loans.

Japan, West Germany, Italy, and France have been primary donors of aid and equipment to the Philippine telecommunications sector. Among other projects, in a test of commercial equipment, Siemens donated a fiber optic cable linking two Philippine islands. French and Italian telecommunications companies are major actors in the development of the telecommunications components of several EDZs.

The Ninth Yen Fund financed a transmission network. The Japanese have also helped to carry out a number of feasibility studies for telecommunications projects. If these projects come to fruition, Japanese companies are likely to provide the technology for them.

PLDT recently received approval of a $70 million loan from the IFC and the Kreditanstalt fur Wiederaufbau. The loan will help the PLDT carry out its 1989-1991 expansion plans. PLDT is also negotiating assistance of $84.7 million from other foreign aid sources.

In sum, finance in the telecommunications sector is tight. Lack of financial resources will prevent investment and growth in a sector which both needs to be developed and holds great economic potential for the Philippines.

TRANSPORTATION

THE PHILIPPINE TRANSPORTATION SECTOR

What is the <u>status</u> of transportation systems in the Philippines?

Roads are the most important means of transportation in the Philippines. They carry 80% of the passenger traffic, while seas carry 10%, air travel carries 9%, and railroads carry only 1%. A study of the Philippine transportation sector carried out in 1988 by the SGV group, for the United States Department of Commerce, found that the overall condition of road networks in the Philippines was very poor. According to the study, less than 20% of the total road network is all-weather; design of roads is poor, causing them to fall into disrepair quickly; and many bridges are weak, or are missing altogether.

While **sea travel** carries only 10% of the passenger traffic, it accounts for 40% of freight traffic. The existing network of ports is quite large; however, many need maintenance and repair, particularly many of the secondary and feeder ports.

There are over 200 **airfields** in the Philippines. One hundred and fifteen are private, the rest are government owned. Air travel is expensive and is therefore inaccessible for the average Filipino. As with the other modes of transportation, what is required is equipment and facility update and repair, rather than development of new airfields.

Rail travel is not used extensively in the Philippines because the system's facilities are limited. There is one railroad which runs north, out of Manila, another which runs south. There is also a Metropolitan Manila commuter system. All of these systems are in need of maintenance, repair, and improvement.

As with the telecommunications sector, there is a dichotomy between the level of development of transportation networks in the rural regions of the country and the urban areas. Transportation systems in rural areas are underdeveloped; this underdevelopment often impairs the ability of the rural farmer to transport goods to urban markets, where they might fetch higher prices. Existing roads, bridges, and ports in rural areas need repair, and many areas need hardtop roads with higher carrying capacity installed.

In Manila there is a serious problem of traffic congestion. This has been eased slightly by the installation of a modern traffic light switching system and the building of a 15 kilometer light rail system, which has been in operation since 1985. However, the problem remains severe; it can take hours to get from one side of the city to the other. In addition to creating traffic congestion the huge number of cars and jeepneys also add to the air pollution problems in the Manila area.

What <u>government agencies</u> affect the Philippine transportation system?

Department of Public Works and Highways - The DPWH is the primary government actor in the transportation sector. DPWH is responsible for national and urban road networks - it plans, designs, and executes their construction. The construction of rural roads, however, may be left to the **Department of Local Governments**; secondary roads in cities may be the responsibility of the city governments.

Department of Transportation and Communication - The DOTC is responsible for licensing private cars and other motor vehicles. It also oversees the functioning of the Light Rail and Manila's public transportation.

Philippine Port Authority - The PPA is responsible for the development and maintenance of Philippine ports. PPA plans for port development must be approved by NEDA to ensure that they are synchronized with national development plans.

Philippine National Railway - The PNR is the organization responsible for the development and maintenance of the Philippine railways.

What are government priorities and programs for the modernization of the Philippine transportation sector?

According to the Philippine Agenda for Sustained Growth and Development, the primary priorities of the government are to privatize and liberalize the transportation sector. Transport facilities and sea ports are to be privatized; pricing and franchising will be opened up. In this manner, free competition will encourage lower freight prices and passenger fares, and the private sector will assume some of the weight of re-building and modernizing the sector.

Specific actions undertaken by the DPWH in 1989 include the construction or renewal of 739 Kilometers of major roads, 4,802 kilometers of minor roads and 1,359 kilometers of barangay roads. The DLG completed work on 739 kilometers of provincial, municipal, and barangay roads.

During the period of 1986 - 1989 a number of major port redevelopment projects have been initiated. Those which have been completed include Cebu, Zamboanga, Cagayan de Oro, Davao and the Port of Manila's International Container Terminal. Those still underway are the North and South Harbors of the Port of Manila. The Port of Barangas is also due for repairs. In addition, in 1987 a rural port redevelopment program was initiated. Under this program approximately 20 outlying ports will receive repair and update by 1992.

In terms of airfield and terminal development, a number of projects are underway. Ninoy Aquino airport was provided with an updated Automatic Teletype Message Switching system and an Instrument Landing System in 1989. Other airports have been upgraded and expanded; the DOTC is currently bidding out the modernization of 32 air navigation facilities.

In Manila, the improvement and expansion of the Light Rail System is under consideration. It is likely that this will be bid out on a Build-Operate-Transfer status.

In general the government is encouraging contract maintenance of transportation facilities by the private companies, so that the burden of upkeep will be shifted to the private sector.

Four out of the five Economic Development Zones (EDZs) being established with the assistance of the MAI/PAP focus on the development of their transportation infrastructure.

- **Calabar** emphasizes the development of the Batangas Port as a viable alternative to the overcrowded Port of Manila. It also plans for the upgrade and development of 57 kilometers of railway between Calamba and Batangas.

- **Panay-Negros** plans for the development of over 200 kilometers of road, 117 kilometers of railway, a number of feeder ports and the resurfacing of the regional airport's runway.

- **General Santos** is based in the development of an agro-industrial complex in a port area. In addition, the development of the Makar Port is part of the EDZ's plan, as is the upgrading of the Buayan Airport.

- **Cagayan de Oro** has plan for the development of roads and bridges, as well as the upgrading of its airport. In addition, municipal vehicles are to be purchased.

The financing for these projects is varied. In some cases the source has yet to be identified, in others the Government of the Philippines is assuming responsibility, via the DOTC or the DPWH. Under the PAP some donors have committed to the development of a number of the projects. As with the other sectors of the Philippine economy, financing is tight, and the Aquino government encourages private sector participation.

SPECIAL ASSISTANCE FOR U.S. BUSINESSES

SPECIAL ASSISTANCE AVAILABLE TO U.S. BUSINESSES

In August 1989 the A.I.D. Office of Private Sector Development, Bureau for Asia, Near East and Europe, prepared a thorough paper outlining the different agencies that assist U.S. Businesses wishing to enter the Philippine market. The paper is available through the U.S. - Philippine Business Council. The following is a brief synopsis of the information contained in the paper.

Department of Agriculture
Foreign Agriculture Service
Washington, D.C. 20250
Phone: (202) 447-8732

The Foreign Agriculture Service (FAS) provides a number of informational services, trade mission opportunities, and credit and credit guarantees in the agriculture sector.

In the Philippines the FAS has been active primarily in export credit guarantee programs, a targeted export assistance program, a foreign market development program (including promotion of soybeans, cotton, leather, meat and wheat), and trade and development missions.

Department of Commerce
International Trade Administration
14th Street and Constitution Avenue, NW
Washington, D.C. 20230
(202) 377-2000

The International Trade Administration's (ITA) services are similar to those of the FAS, although less sector-specific. It provides export assistance, particularly to small and medium sized enterprises. Services are information-oriented. Trade development programs are active, and include trade fairs and missions in potential markets for certain targeted U.S. goods. The ITA engages in all of these activities in the Philippines.

Export-Import Bank of the United States
Office of the Corporate Secretary
811 Vermont Avenue, NW
Washington, D.C. 20571
Phone: (202) 566-8871
Fax: (202) 566-7524

The Ex-Im Bank is an independent U.S. government agency which facilitates and finances the purchase of U.S. exports. This is done by directly funding the purchasers of U.S. goods, offering loans and loan guarantees, and a number of credit insurance programs. Ex-Im designs its services to allow for effective financial planning and management. Outside of loan programs, it is generally the responsibility of the U.S. supplier to contact the Ex-Im bank for assistance.

Insurance is provided through the Foreign Credit Insurance Association (FCIA). Credit Insurance policies to cover the risk of non-payment, leasing of equipment, and consignments are available. FCIA information can be obtained from the Washington office, or from regional offices in New York, Chicago, Houston, Los Angeles, or Miami.

The Ex-Im bank has added no new loans to its $1.1 billion portfolio in the Philippines in the last two years, though projects in the power and telecommunications sectors are currently under consideration.

International Finance Corporation
14th Street and Constitution Avenue
Washington, D.C 20230

The International Finance Corporation (IFC) is an affiliate of the World Bank. It is the largest source of direct project finance for private investment in the developing world. The IFC works to link up capital and provide funding for investment projects for local businessmen; it sometimes will participate in projects directly, though it will not invest alone.

In the Philippines the IFC has recently made a number of investments in capital market development, construction, shipbuilding, textiles, power, and telecommunications. It actively provides investment advisory services to Philippine businesses, and will help to develop financial plans and to identify alternative capital investment programs.

Assistance

Multilateral Investment Guarantee Authority
1818 H Street, NW
Washington, D.C. 20433
Phone: (202) 473-6168/6162
Fax: (202) 334-0265

The Multilateral Investment Guarantee Authority (MIGA) is the newest member of the World Bank Group. It provides a number of services to promote investment in developing countries:

- Guarantee Program (Political Risk Insurance)
- Advisory and Investment Promotion Services to Developing Member Countries

MIGA has been actively providing these services in the Philippines.

Overseas Private Investment Corporation
1615 M Street, NW
Washington, D.C. 20527
Phone: (800) 424-6742
(202) 457-7010

The Overseas Private Investment Corporation (OPIC) provides qualified US businesses with:

- Political Risk Insurance
- Loans and Loan Guarantees
- Pre-Investment Assistance
- Investment Opportunity Matchmaking
- Special Insurance Programs, particularly in the energy sector

OPIC has a number of qualifications which firms must fulfill in order to be considered eligible for assistance.

OPIC plays an active role in political risk insurance, financing, investment missions, and other investment advisory services in the Philippines.

PAPS Pre-Investment Facility
See Briefing Book Section on the MAI/PAP, U.S. Activities

Assistance

The Trade and Development Program
Room 309
SA-16
Washington, D.C. 20523-1602
Phone: (703) 875-4357
Fax: (703) 875-4009

The Trade and Development Program (TDP) funds feasibility studies and other project planning activities for U.S. investors interested in investing in developing countries.

TDP financing mechanisms vary according to circumstances. If a private U.S. investor will have equity participation, TDP will co-finance planning services. Major public sector studies may be fully financed. The recipient country will bear the costs of technical assistance coordination.

TDP in the Philippines acts through the Manila Office of the U.S. Foreign Commercial Service (FCS). The FCS office works in coordination with the National Economic Development Authority in identifying new public sector projects.

TDP has funded Philippine activities such as the creation of a Manila International Airport Master Plan; a plan for management of hazardous waste management for Laguna Lake; feasibility studies for a bulk handling terminal in the Manila Port; a Manila solid waste management plan; study for the development of a co-generation power plant on the grounds of the Mariwasa Tile Company; the study of six geothermal sites in Luzon; planning the modernization of the Philippine National Railways; and a feasibility study of power generation from rice husk residue.

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