WORLD TRADE ORGANIZATION

RESTRICTED

WT/TPR/G/149
7 June 2005

(05-2263)

Trade Policy Review Body

Original: English

TRADE POLICY REVIEW

Report by

THE PHILIPPINES

Pursuant to the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), the policy statement by the Philippines is attached.

CONTENTS

I. DEVELOPMENTS IN THE ECONOMY: 1999-2004

(1) Overall Economic Performance

1. Since its last review in 1999, gross domestic product (GDP) grew annually by an average of 4.5% and in 2004, GDP grew by 6.1%, the highest rate since 1997. The growth was attended by strength in the services, industry and agriculture sectors. Gross national product (GNP) also expanded by 6.1% in 2004. The improvements in the economy can be attributed to the Government's sound economic management as well as the consistent demand for overseas Filipino workers especially professional workers, the increase in minimum wages for non-agricultural workers and the continued investments in the information and communications technology (ICT) sector and power and construction industry.

Table 1
Selected Macroeconomic Indicators

	1999	2000	2001	2002	2003	2004
Real GNP (growth rate in %)	3.7	4.8	3.5	4.3	5.6	6.1
Real GDP (growth rate in %)	3.4	4.4	3.0	4.3	4.7	6.1

Source: National Statistical Coordination Board; National Economic Development Authority.

2. The Philippine economy continues to demonstrate resiliency and growth, although a fiscal problem has emerged which is currently being addressed as a priority. Certain events and factors during the past five years did pose challenges to the country's economic performance, ranging from the external shocks of the September 2001 World Trade Center and October 2002 Bali bombings, the US-Iraq war, Severe Acute Respiratory Syndrome (SARS) and the avian virus epidemics, as well as internal events, such as terrorist threats, a failed military mutiny in 2003, the May 2004 elections, and a series of calamities towards the end of 2004.

(2) Sectoral Growth

3. In 2004, the services sector was the most important driver of the economy, contributing about 3.4% to GDP growth and accounting for 47% share of the total GDP. All services sub-sectors posted accelerated growth with the highest rate reflected in the communications industry, brought about by the Government's previous liberalization efforts in telecommunications and retail trade. The mobile cellular services industry continues to widen its consumer base through innovative methods and applications, which in turn created new businesses and retail channels.

4. Industry contributed 1.8% to total GDP growth in 2004 and accounted for 33% share to total GDP. In 2001, the global economic slowdown disrupted the upward direction of the industry sector with the decline in construction and mining and quarrying. Manufacturing and electricity, gas and water growth performance also slackened during this year. This has since improved. Manufacturing performed strongly and construction rebounded in 2004, although mining and quarrying growth decelerated during the year as metal mining companies (gold, copper and nickel) suffered cutbacks in production. With the latter, the Supreme Court's decision in 2004 to allow foreign firms to take the lead in exploration and production is expected to revive the mining industry in future years.

5. The Agriculture, Fishery and Forestry sector, which accounted for 20% of total GDP, contributed 0.97% points to GDP growth in 2004. The Agriculture sector was the top contributor to GDP growth. Agriculture benefited from favourable weather conditions as well as from the government's infrastructure, financial and technical support programs such as the construction and

rehabilitation of irrigation and post-harvest facilities, aggressive distribution of high-yielding variety and hybrid seeds, fertilizer and financial/credit programs.

Table 2
Sectoral Growth Rates and Share of GNP
(Percent)

	1999	2000	2001	2002	2003	2004
Agriculture						
Growth rate	6.5	3.4	3.7	3.8	3.8	4.9
Share	20.2	20.0	19.9	19.7	19.8	19.5
Industry						
Growth rate	0.9	4.9	0.9	3.6	3.8	5.3
Share	34.5	34.7	34.8	34.5	33.5	33.2
Services						
Growth rate	4.0	4.4	4.3	5.1	5.8	7.3
Share	45.3	45.3	45.3	45.8	46.7	47.2

Note: Details may not add up to totals due to rounding.

Source: National Statistical Coordination Board; National Economic Development Authority.

(3) EXTERNAL TRADE

6. Free enterprise continues to guide the government's policies and programs in stimulating business and promoting competition. However, the export of goods and services (at constant prices) grew only by a modest average of 7.26% for the five-year period. The rate was pulled down by a slump in world semiconductors industry in 2001. Electronics continue to dominate a large portion of total exports (in current dollars) with semiconductors alone accounting for 47% of goods in 2004, followed by garments (5.5%) and machinery and transport equipment (4.0%). The top three destinations for exports are Japan, United States and Netherlands. Services exports rebounded in 2004 after several years of decline. Growth came from increased travel, transportation and business processing outsourcing activities.

7. Imports of goods and services (at constant prices) also grew at an average of 5.02%. Electronics and components, office and EDP machines, telecommunications equipment, mineral fuel and lubricants, industrial machinery and other capital equipment constituted majority of imports.

Table 3
Trade Performance
(Growth rate in percent, constant 1985 prices)

	2000	2001	2002	2003	2004
Total exports of goods and services	17.7	-3.4	3.6	4.4	14.0
Merchandise exports	22.7	-1.6	5.0	5.4	13.8
(Non-factor services)	-3.3	-13.0	-4.6	-2.2	15.6
Total imports of goods and services	4.0	3.5	4.7	10.2	6.3
Merchandise imports	10.2	7.1	6.4	10.2	6.3
(Non-factor services)	-31.2	-28.2	-16.8	10.2	5.5

Source: National Statistical Coordination Board.

II. LIBERALIZATION THROUGH DOMESTIC REFORM

(1) STRUCTURAL REFORM

8. Structural reforms have long been recognized by the Government as fundamental elements to achieve economic prosperity and growth. Subsequently, a number of critical economic reform bills were passed and new policies were implemented during the period of review from 1999-2004 to strengthen the banking sector, improve access to credit, restructure the electric power industry, address the fiscal problem and improve governance.

Financial Sector

9. The General Banking Act of 2000 increased the capacity of the *Bangko Sentral ng Pilipinas*' (Central Bank or BSP) to take prompt corrective action against problem banks. In 2001, guidelines were issued to reinforce the Bank's regulatory oversight functions and to tighten provisionary requirements as well as to level the playing field between foreign currency and peso intermediation.

10. The Anti-Money Laundering Act of 2001 and its amendments (RA 9140) introduced in 2003 lowered the deposit threshold at which bank regulators may inspect from four million pesos to half a million pesos. The Act demonstrates the Government's commitment in the global crusade against money laundering.

11. In 2003, Congress passed the Special Purpose Vehicle (SPV) Act, providing the framework for banks to sell nonperforming assets to third parties and granting fiscal incentives and regulatory relief for such transfer or sale by banks and other financial institutions. The Securitization Act of 2004 strengthens further the SPV framework. It is intended to create an enabling environment for securitization as a means of developing the domestic market and to harness its potential in generating long-term funds to support broader business undertakings.

Microfinance

12. In 2000, the BSP declared microfinance as its flagship program in support of the government's thrust of poverty alleviation. In setting the path for the development of a sustainable microfinance sector, the BSP focused on fostering a favourable policy and regulatory environment, providing training and capacity building and incorporating promotion and advocacy in its programs.

13. More specifically, on the policy reform side, the BSP issued circulars to jumpstart the development of microfinance. These circulars are enumerated below:

- Circular No. 272 defines microfinance loans as small loans not exceeding P150,000 granted to the basic sectors, poor and low-income households for their microenterprises and small businesses. These loans are granted on the basis of the borrowers' cash flow and are typically unsecured;

- Circular No. 273 lifts the general moratorium on the licensing of new thrift and rural banks to allow the entry of microfinance-oriented banks;

- Circular No. 282 sets the guidelines governing the Rediscounting Facility available to rural banks and cooperative banks for the purpose of providing liquidity assistance to support and promote microfinance programs;

- Circular Nos. 340, 365, 369, set rules and regulations for the establishment of branches of microfinance-oriented banks/loan collection and disbursement points;

- Circular No. 364 provides a lower risk weight for banks' SME and microfinance loan portfolios that meet prudential standards. This reduction in risk weight allows banks to support a potential expansion in SME and microfinance loans and helps promote growth and development of SMEs throughout the country.

Creation of Credit Information Bureau

14. To support banks' access to credit information, the BSP is pushing for the formation of a central credit bureau, which would hold a centralized databank of borrowers' history of transactions. This would allow banks to lower their interest rates since the bureau could pare down losses by carefully assessing customers' credit history. The enabling law which will create a central bureau is still pending in Congress. In the interim, the BSP issued guidelines in June 2004 governing the development and implementation of banks' internal credit risk rating systems to ensure that banks' credit management processes are sound and effective.

SEC Reforms on Non-bank Financial Sector

15. In 2004, the SEC spearheaded the creation of a blueprint for the development of the non-bank financial system. Though, still in the finalization stage, parts of the blueprint are already undergoing implementation.

16. Following the banking sector's lead, the SEC has laid out the guidelines for the eventual shift to a risk based capital adequacy framework among its regulated and monitored entities. Likewise, SEC approved the creation of a Fixed Income Exchange (FIEX) in 2004. The FIEX serves as a secondary market for government securities and an alternative source of funds from the traditional banking system. The system is expected to be fully operational in 2005.

Trust Funds

17. Through Circular No. 447, the BSP paved the way for the creation of Unit Investment Trust Funds (UITF) by authorized trust entities. UITF is an improved version of Common Trust Funds (CTF) which is a collective investment scheme similar to a mutual fund that pools the investments of small investors into a larger fund under professional management that is able to access more superior investment opportunities that are not normally available to individual players.

18. However, unlike CTFs, UITFs are not subject to reserve requirements and are not considered in single borrowers limit calculations because BSP considers UITFs to have clearer safeguards that effectively distinguish them from deposit substitutes. The BSP expects UITFs to completely replace CTFs over time.

Power Sector

19. The Electric Power Industry Reform Act of 2001 was signed into law in 2001. It is designed to bring down electricity rates and to improve the delivery of power to end-users by encouraging greater competition and efficiency in the electric power industry. The Act also created the Power Sector Assets and Liabilities Management Corporation (PSALM) to oversee the privatization of the National Power Corporation (NAPOCOR).

20. NAPOCOR was granted an increase of 98 centavos per kilowatt-hour and the government also absorbed P200 billion of the corporation's debt. These are expected to improve NAPOCOR's financial position.

Fiscal Policy

21. In support of fiscal consolidation efforts, the Philippine Government sought to improve the operations of revenue collecting groups, such as the Bureau of Internal Revenue and Bureau of Customs to meet its revenue targets. Information and communication technology was an important tool to modernize these agencies' operations and enhance productivity.

22. On the legislative front, the President signed into law on 20 December 2004 the bill on indexation of excise taxes on alcohol and cigarettes, one of the measures to address the weakness of the current excise tax system. The law became effective on January 1, 2005. The Lateral Attrition Law (RA 9335) which seeks to improve the collection performance of the Bureau of Customs and the Bureau of Internal Revenue through a rewards and penalty system was also signed into law in January 2005. Meanwhile, VAT reform and the rationalization of fiscal incentives are currently being deliberated at the Senate.

23. The Government also pursued expenditure rationalization and management programs, such as the adoption of the Organizational Performance Indicators Framework to enable agencies to focus on strategic programs and projects and establish the linkage between the agencies' major financial outputs and the objectives. Other aspects of the program include the conduct of Agency Performance Reviews, which is the basis for resource allocation decisions and the implementation an e-Budget System for the computerized processing of budget releases and preparation of accountability reports.

Good Governance

24. To create greater transparency, accountability, efficiency and equal opportunity in the government procurement system, the Government Procurement Reform Act of 2002 was enacted into law in January 2003. As part of the government's effort to widen public access, it implemented the e-Procurement System (EPS), an internet-based service which include: a Public Tender Board for procurement notices; a catalogue and virtual store for procurement service transactions with government agencies; and a suppliers' registry to provide agencies a common list of accredited suppliers to support invitations to bid.

25. The Government also stepped up efforts to make the Bureau of Internal Revenue and Bureau of Customs its showcase agencies in the fight against corruption. Administrative cases and formal charges have been filed against delinquent personnel. The Government also solicited the assistance of civil society groups in identifying priority areas in the drive to reduce red tape and corruption.

(2) FOREIGN INVESTMENT LIBERALIZATION

26. To attract and promote local and foreign investments, the Government continued to undertake reforms aimed at investment liberalization, deregulation and privatization. Executive Order No. 95, issued in April 2002, amended the Fourth Regular Foreign Investment Negative List (Executive Order 286; issued in 2000) to allow foreign nationals authorized by the Secretary of National Defense to engage in defense-related manufacturing or repair activities, provided a substantial percentage of output is exported. Under the Fifth Regular Foreign Investment Negative List (Executive Order 129; issued on 22 October 2002), full foreign participation is allowed for retail trade enterprises (a) with paid up capital of US$2.5 million or more provided that investments for establishing a store is not less

than US$830,000; or (b) specializing in high-end or luxury products provided that the paid up capital per store is not less than US$250,000 (Section 5 of RA 8762).

27. Executive Order 389, promulgating the Sixth Foreign Investment Negative List, was issued on 30 November 2004 and took effect on 7 January 2005. It reflects two changes to List A, which limits foreign ownership by mandate of the Constitution and specific laws. Item 7 of List A was clarified to indicate that small-scale utilization of natural resources in rivers, lakes, bays and lagoons is also reserved to Filipino citizens as provided under Article XII Section 2 of the Constitution. In Item 18, "Ownership of private lands," Section 4 of RA 9182 or the Special Purpose Vehicle Act was added as a legal basis for the 40 percent foreign equity limitation for private land ownership in addition to Article XII, Section 7 of the Philippine Constitution and Chapter 5, Section 22 of Commonwealth Act No. 141.

28. No changes were made to List B, which contains activities where foreign ownership is limited for reasons of security, defense, risk to health and morals as well as protection of domestic market enterprise with paid-in equity capital of less than the equivalent of US$200,000.

29. The rules and guidelines on the establishment and maintenance of multinational companies' Regional or Area Headquarters (RHQs), Regional Operating Headquarters (ROHQs), and Regional Warehouses (RWs) was signed into law in November 1999 (Republic Act No. 8756). The law provides for favourable tax treatment and other non-fiscal incentives, for both the RHQs and ROHQs and their alien and Filipino employees. It expands the eligible locations of regional warehouses to include economic zones and relaxes the limitations on the storage period of goods and the withdrawal of goods for domestic use. The law also sets out new immigration procedures, providing for a longer residence visa to expatriate personnel.

30. Starting 2002, the Philippine Annual Investments Priorities Plan (IPP) was shortened but made more focused. The Plan focused on identified economic priority areas and activities, at the national and regional levels, with the objective of accelerating the promotion of domestic and foreign investments to sustain the country's growth momentum. In 2004, the IPP gave emphasis on sustaining globally competitive industries given an environment of increasing trade liberalization. New areas such as medical tourism and environmental services packaging were included in the 2004 IPP.

31. The Government filed a motion for the Supreme Court to reconsider its January 2004 decision on the unconstitutionality of foreign ownership in the Mining Act of 2005 under the provision on Financial or Technical Assistance Agreement and Mineral Processing Permits. In December 2004, the Supreme Court reversed the negative legal decision. The development is expected to revive the under-performing mining industry with the projected investments in large-scale metallic mining and mineral exploration activities.

III. TRADE POLICY DEVELOPMENTS

(1) THE PHILIPPINES AND THE WTO

32. The Philippines holds with importance its membership in the World Trade Organization and recognizes the value of the WTO's achievements in fostering a more open, transparent, predictable and competitive environment. With its membership in 1995, the Philippines made substantial commitments on market access and at the same time continued to consolidate the liberalisation programme under the Tariff Reform Program, undertaken unilaterally since the 1980s.

33. The Philippines also completed implementation of its commitment under the Information Technology Agreement with the issuance of Executive Order 395 on 31 December 2004 eliminating the duty on certain sensitive IT products.

(2) THE DDA NEGOTIATIONS

34. The Philippines is an active participant in all negotiations and meetings including the various committees and working parties. It fully supports the Doha Development Agenda (DDA), stressing consistently that the multilateral trading system can genuinely contribute to economic growth and development if the negotiations remain true to its developmental spirit. Developing countries constitute majority of WTO members and priority must be given to their needs and concerns. As a founding member of the G-20, the Philippines is deeply concerned with and will continue in the course of the negotiations to work towards correcting the imbalances on the distribution of benefits accruing from the multilateral trading system.

Agriculture

35. The Philippines believes that the DDA should lead towards the balanced emphasis on the three pillars of the negotiations, namely market access, export subsidies and domestic support. It will continue to support for substantial and permanent reforms in domestic support disciplines and the elimination of export competition measures with clear deadlines. The Philippines fully supports paragraph 11 (Annex A) of the General Council (GC) Decision of July 2004 which affirms the policy space for developing countries to pursue developmental goals. Paragraph 11 exempts from any reduction commitments developing countries that have allocated or intend to allocate most of their *de minimis* support for subsistence and resource-poor farmers.

36. The Philippines is committed to ensure that paragraph 41 (Annex A) of the GC decision recognise fully the concept of Special Products and the fundamental right of developing country Members to designate products as vital to their food security, livelihood security, and rural development needs. The GC decision assures that Special Products, which is separate and distinct from sensitive products, will be entitled to the most favourable and flexible treatment.

Non-Agriculture Market Access

37. To preserve the flexibilities of developing countries, the Philippines supports a formula approach using two coefficients: one for developed and another for the developing countries. The outcome of the negotiations should take into account the tariff reduction programmes pursued unilaterally by developing countries. The binding of unbound tariff lines should, in itself, be accepted as a major concession and, hence, there should be no reduction commitments for these tariff lines. For unbound tariffs, there should be flexibilities for developing countries to bind at levels higher than what is proposed in Annex B of the July GC decision and to exempt a greater percentage from binding. The Philippines also recognizes the importance of addressing non-tariff barriers (NTBs). It would be useful to have a focused discussion on NTBs and how to address them beginning with products of export interest to many developing countries such as the textiles and clothing sector.

Services

38. The Philippines joined other countries in submitting proposals on the guidelines and procedures for negotiations in trade in services and on the liberalization of Mode 4. Liberalization of temporary movement of natural persons addresses important market access concerns of developing and developed countries alike. The Philippines shares the disappointment of some members on the quality of commitments in areas where developing countries have comparative advantages,

specifically for categories of personnel not related to commercial presence and at lower skill levels. Current offers essentially do not provide substantial improvements to existing specific commitments in Mode 4.

Implementation Issues

39. On the negotiations on TRIPs, the Philippines has joined developed and developing countries in opposing any moves towards a legally binding multilateral system of registration and notification of geographical indications (GIs) for wines and spirits. It believes that participation in the multilateral system of notification and registration of GIs for wines and spirits must be voluntary.

40. On special and differential treatment (S&D), the Philippines shares the view that S&D be strengthened and not limited in application to providing longer time frames for developing countries. This position confirms Philippine support for the need to ensure that the high level of ambition in the DDA comes with a strong and renewed emphasis on development.

Rules

41. The Philippines supports the negotiations to clarify and improve existing WTO agreements on anti-dumping, countervail and subsidies (including fisheries subsidies) and regional trading agreements (RTAs). The Philippines is a user of anti-dumping provisions, although it has not yet utilized the countervailing and subsidies provisions. Negotiations should lead to improvements of certain provisions of the agreements to prevent gross misuse without limiting a country's ability to use valid contingent protection.

42. The Philippines also supports the development of further disciplines on subsidy practices and predictable disciplines on fisheries to reverse over-capacity and over-fishing. On RTAs, negotiations should ensure that RTA rules will remain faithful to the MFN principle and will not result in the marginalization of non-RTA participants.

Trade Facilitation

43. The Philippines agreed to adopt Annex D of the July decision on the modalities for negotiations on trade facilitation, a position consistent with the statement adopted by APEC Trade Ministers in its June 2004 meeting in Pucon, Chile. Although trade facilitation *per se* offers numerous benefits especially in reducing inefficient procedures and increasing transparency, the costs for infrastructure development are substantial. Annex D highlights the importance of technical assistance and support for capacity building for developing and least-developed countries to allow them to participate actively and benefit from the negotiations. The Philippines agrees that while negotiations may lead to implementation commitments requiring infrastructure development, developing countries are not legally bound to implement such commitments if infrastructure assistance and support from developed countries are not forthcoming and if developing countries and least-developed members continue to lack the necessary capacity.

Dispute Settlement Understanding

44. While the WTO dispute settlement mechanism is an improvement over its GATT predecessor, the Philippines believes that certain aspects need to be reviewed and amended to make the system more useful especially for developing countries. Together with Thailand, it re-tabled its proposal regulating carousel, the practice of rotating or indiscriminately changing the products to be subjected to retaliatory treatment by the aggrieved member.

(3) BILATERAL AND REGIONAL TRADE RELATIONS

45. Apart from its engagement in the WTO, bilateral and regional trade relations remain equally important, with a bulk of the Philippines' international economic engagement taking place within the ASEAN. ASEAN has completed negotiations and signed the related framework agreement and protocols to implement the Priority Integration Programme (PIP) covering 11 priority integration sectors that aims to accelerate further the almost completed Common Effective Preferential Tariff Scheme under the ASEAN Free Trade Area (CEPT-AFTA) by reducing tariffs to zero by 2007 rather than 2010.

46. In addition to the ASEAN Free Trade Area, ASEAN is engaged with its various Dialogue Partners to implement or discuss free trade areas. The Philippines is set to implement this year the ASEAN-China FTA in goods for completion in 2010 with flexibility to 2012. The country is also negotiating with ASEAN and India a similar FTA to be completed by 2011 between Brunei Darussalam, Indonesia, Malaysia, Singapore, Thailand and India; and by 2016 between CLMV (Cambodia, Laos, Myanmar, and Vietnam), the Philippines and India.

47. Similarly a possible FTA between ASEAN and Japan is being worked out for completion in 2012 with flexibility particularly for the CLMV. Likewise, an ASEAN-Korea FTA is envisioned to be realized by 2009 for the original ASEAN-6 and Korea and by 2014 for the CLMV and Korea. Negotiations will commence this year. Meanwhile, the ASEAN and the Closer Economic Relations (CER) countries of Australia and New Zealand are set to negotiate also starting this year an FTA to be realized within a 10-year period.

48. Bilaterally, the Philippines has taken a cautious approach on FTAs with only one bilateral FTA envisioned so far. In 2004, the Philippines and Japan reached an agreement in principle on the major elements of the Japan-Philippines Economic Partnership Agreement which aims to promote a freer trans-border flow of goods and services between the two countries including a comprehensive partnership that covers, among others, HRD, ICT, and SMEs.

49. The Philippines is committed to constructive participation to forge the planned partnerships with emphasis on maintaining policy flexibility but fully consistent with the existing rules under the multilateral trading system, particularly GATT Article XXIV, GATS Article V as well as the Enabling Clause.

IV. FUTURE POLICY DIRECTIONS

50. The eradication of poverty is our biggest development challenge. The Medium-Term Philippine Development Plan of 2004-2010 recognizes the significant contribution of trade and investment to achieve the Government's goal of economic development and job creation. Based on the Plan, internally determined measures relating to macro-economic stability, employment, trade and investment, agribusiness, power sector reforms, infrastructure, science and technology and anti-corruption will be pursued to strengthen Philippines' competitiveness and contribute to creating jobs. The Plan also acknowledges the need for fundamental reforms and a review of the economic provisions of the Constitution, especially the provisions which do not encourage economic innovations and reforms, to attract more foreign capital and investment. All these reforms will be considered to promote employment and economic growth.

____