

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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## Committee on Balance-of-Payments Restrictions

### REPORT ON THE 1980 CONSULTATION WITH THE PHILIPPINES

1. The Committee has consulted with the Philippines in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (L/4904). The consultation was held on 15 October 1980 under the chairmanship of Mr. R.J. Martin (Canada). The International Monetary Fund was invited to participate in the consultation pursuant to Article XV of the General Agreement.
2. The Committee had the following documents before it:
  - Basic document supplied by the Philippine authorities (BOP/208 +  
Corr.1 and 2)
  - Secretariat Background Paper (BOP/W/45)
  - IMF Recent Economic Developments, dated 22 July 1980.

#### Opening statement by the representative of the Philippines

3. In his opening statement, the full text of which is attached as Annex A, the representative of the Philippines reviewed the balance-of-payments developments in the 1970s, the external debt situation, the exchange rate policies, the prospects and policies for 1980 and the measures adopted by the Philippine Government to bridge the payments gap. He said that non-traditional exports, which had accounted in 1970 for only 7 per cent of exports, had grown during the last decade by an average of 46 per cent per annum and accounted today for 43 per cent of total export receipts. In the early 1970s only some 20 per cent of exports went to countries other than the United States and Japan; today the share was 44 per cent. The debt service ratio had been 34 per cent in 1970, now it stood at about 20 per cent. In 1980, the payments deficit was expected to decline to US\$380 million from US\$570 million in the previous year. Exports were expected to increase by 31 per cent and imports by 28 per cent, the latter mainly due to a sharp rise in the oil import bill which now stood at US\$2.5 billion and accounted for about 30 per cent of total imports. The representative of the Philippines stressed that the growth of non-traditional exports would have been faster if protectionist measures, in particular on garments, had not been imposed by some countries. In order to bridge the balance-of-payments gap the Philippine authorities had instituted an energy programme designed to develop domestic sources of energy, an industrial development programme aimed at expanding non-traditional exports, and export promotion measures.

4. The Philippine representative concluded by pointing out that the government had established a phased plan for the extensive liberalization of imports. It was its policy to use restrictive import measures only to a very limited extent, to phase them out as soon as feasible and to apply them non-discriminatorily. Taking into account the prospects for the remainder of 1980, the restrictions on the import of the items listed in the Annexes A and B of document BOP/208 were however essential for the safeguarding of the balance of payments.

Statement by the International Monetary Fund

5. In his statement, the full text of which is attached as Annex B, the Fund representative reviewed recent developments in the Philippine economy and the economic policies pursued by the Philippine authorities.

Balance-of-payments position and prospects, alternative measures to restore equilibrium

6. Members of the Committee introduced their remarks by commending the Philippine authorities on the important trade liberalization measures adopted in recent months and on their responsible approach to the management of balance-of-payments problems which they considered consistent with the Philippine commitments to the GATT. It was pointed out that the tariff reform and liberalization of commodity import procedures should encourage greater efficiency in domestic industry and help ease inflationary pressures. The implementation of the import liberalization policies needed to be complemented however by efforts to generate domestic savings for investments through the establishment of positive interest rates and by a flexible exchange rate policy which would counter any erosion of export competitiveness due to domestic inflation and any balance-of-payments pressures arising from the import liberalization.

7. Several members of the Committee, noting that primary products had in the past accounted for a considerable share of export receipts, wondered what policies the government had adopted to diversify exports. In reply the Philippines representative said that the government promoted the export of manufactures by introducing fiscal incentives for production for export, by establishing trade promotion centres abroad and by simplifying export procedures. Non-traditional exports, which had accounted for 7 per cent of export receipts in 1970, now accounted for 43 per cent of export receipts. The progress would have been faster if there had not been import restrictions in other countries and if all major trading units had granted non-discriminatory access to their markets. One particularly successful product area was that of electronic equipment, the foreign sales of which had increased from US\$1.8 million in 1972 to US\$405 million in 1979, making it one of the Philippines' ten leading export items.

8. Committee members stressed the importance of maintaining a flexible exchange rate policy designed to counter any possible erosion of export competitiveness and to avoid pressure for reversion to higher import barriers. In this connexion one member observed that the trade-weighted nominal exchange rate of the peso had risen slightly between December 1978 and June 1980. The Philippine representative said that export competitiveness was not a problem at present. Export receipts from manufactured goods had increased in 1979 by 41 per cent, which would not have been possible if the exchange rate had been at an inappropriate level. The peso had in recent months depreciated slightly against the United States dollar, moving from an average rate of 7.37 pesos to the dollar in the first nine months of 1979 to 7.48 pesos during the same period in 1980.

9. In reply to enquiries on the level of reserves considered appropriate by the Central Bank, the Philippine representative stated that the official reserve position of the Philippines at the end of 1979 stood at US\$2.4 billion. By the end of September 1980 it had increased to US\$2.7 billion. This represented four to five months of import payments. While in the past a lower level of reserves had been acceptable, in light of the present uncertainty in the world economic situation, the Central Bank policy was now to maintain reserve holdings at about this level.

10. Concern was expressed in the Committee over the problems that might arise from potentially higher debt service payments over the next several years. The Philippine representative stated that in 1970 the burden of debt service stood at about 34 per cent of total foreign exchange receipts. Since that time a policy of debt management had been adopted which included the restructuring of debt from short- to medium- and long-term obligations, the discouraging of short-term borrowing and taking maximum advantage of concessional loans with long-term maturities from international financial institutions. As a result of this policy the debt service ratio had been reduced to 18.8 per cent in 1978 and 1979, even though the country's external debt had risen annually on average by about 19 per cent, and was expected to be maintained at that level for 1980. A law presently in force required that the debt service ratio should not go beyond 20 per cent.

11. One member asked whether there might not arise a conflict between the Philippines' financial programme designed to limit the growth of domestic bank assets and credits on the one hand and the government's objective of increasing domestic investment on the other. The Philippine representative replied that the government had committed itself to limit the creation of domestic liquidity to the amount necessary for maintaining a level of economic growth of around 6 per cent with a rate of domestic price increase not exceeding 20 per cent. Included in this commitment was a sub-ceiling that limited government borrowing from the domestic banking sector. As funds raised solely on the domestic market would not be sufficient to generate this growth rate, recourse to foreign investment and foreign borrowing within certain limits was foreseen. In this connexion, one Committee member observed

that the Philippine Government's efforts to generate adequate domestic savings would be successful in the long run only if there were positive rates of return for savers and a realistic structure of interest rates. In reply, the Philippine representative said that, to promote domestic savings, an official savings campaign had been instituted seven years ago, in co-operation with the banking system. Since then, the overall annual rate of growth of savings in the country had increased from 7 to 20 per cent.

12. In response to various questions on trade in agricultural products the Philippine representative said that the government attached great importance to self-sufficiency in the production of rice, the country's main food staple. Self-sufficiency had recently been attained, in fact the Philippines was now exporting some rice. Efforts were made to expand coconut exports through the use of fertilizers and the planting of new high yield varieties of trees. The non-traditional exports of coffee and bananas had shown considerable growth. Sugar exports had remained an important source of foreign exchange. Earnings from sugar exports had fluctuated with the world market price: they accounted for 24 per cent of earnings from Philippine traditional exports in 1976 and 1977, 10 per cent in 1978 and 1979 and should represent about 12 per cent in 1980 as a result of the present favourable world sugar prices. The government had created an agency to channel sugar exports and to participate in the sugar futures market.

13. The Committee discussed in some detail the policies which the Philippine Government had adopted in response to the rise in the oil import bill. The representative of the Philippines said that the share of oil in total energy consumption had been 91.4 per cent in 1979 but was projected to go down to 69 per cent in 1984 and to 56.2 per cent in 1989, a development which would have a favourable impact on the balance of payments. The per capita energy consumption had been the equivalent of 1.96 barrels of oil in 1979, and was expected to go up to 2.2 barrels in 1984 and 3.2 barrels in 1989. The increase in energy consumption was a normal consequence of the process of economic development in which the Philippines were engaged. While energy consumption could not be reduced, a diversification of sources of energy was possible. Of the total energy requirements in 1979, representing the equivalent of 84.9 million barrels of oil, 7.7 million barrels were domestically produced. In 1982 total energy requirements were expected to increase to the equivalent of 93 million barrels of oil, but the share of domestically produced energy was projected to rise to 40 per cent due to greater use of coal, hydro-electric and nuclear power, and of so-called alcogas produced from sugar cane. Under the government's energy programme the mix of energy sources was to change radically in the coming years. Thus, for the purpose of producing electric power, 20.7 million barrels of oil were consumed in 1979. In 1989 only 11.4 million barrels of oil would be used for that purpose with the remaining energy requirements to be drawn from coal (from which energy equivalent to 11.4 million barrels of oil would be produced), hydro-electric installations (23.9 million), geothermal sources (13.5 million), nuclear plants (6.5 million) and other non-conventional sources (3.5 million).

14. In response to a question regarding the financing of the energy programme the Philippine representative said that, during the next ten years, the government planned to invest US\$13.9 billion, of which US\$9.7 billion would be financed from abroad and the remainder from local sources. This programme inevitably would have a major impact on the debt service burden and on the budget deficit, but given the high oil price the government had no option but to carry out the programme expeditiously. Adjustments would be made in other public capital expenditures to partly offset the additional outlays for energy.

System, method and effect of the restrictive import measures

15. In reply to a query on the import liberalization programme adopted by the Philippine government, the representative of the Philippines said that a tariff reform affecting about 75 per cent of all tariffs would go into effect on 1 January 1981. The reform would be carried out in not more than five stages during a four-year period and would be linked to a phased programme for the liberalization of commodity import procedures. Of the 1,304 items now subject to import restrictions made effective through exchange regulatory measures (unclassified and non-essential consumer goods) about 960 would be liberalized during the three years beginning on 1 January 1981. The import substitution policies which had been instituted in the mid-1950s had evolved into export-oriented policies with emphasis on labour-intensive industries. There were however two sectors in which the idea of import substitution had been specifically retained: energy and basic foodstuffs.

16. In response to a comment by a member of the Committee on the import régime applied to socialist countries the representative of the Philippines explained that there was no requirement to import certain goods from socialist countries only. There was merely a policy to give priority to certain categories of goods when imports were made from socialist countries.

17. One member of the Committee asked what the nature and effect of the 50 per cent deposit requirement set by the Banker's Association for letters of credit was, and for what reasons exemptions had been granted. The representative of the Philippines said that the deposit requirement was not a governmental measure but was set by the banks so as to ensure that the importers would pay upon arrival of the goods. Such deposits were in conformity with normal banking practices. It was the practice of the banks to co-operate with the government and some imports had therefore been exempted from the deposit requirement or made subject to a lower deposit rate in recognition of import priorities of the government.

18. Responding to a question on the rationale of the Central Bank's classification of imports the representative of the Philippines said that the classification was originally made for the purpose of allocating scarce

foreign exchange in accordance with the essentiality of the imports at a time when the Bank was in charge of import controls. The shift of a large number of items from the UC to the NEC category in early 1980 was a preparatory step towards the implementation of a programme of phased liberalization of restrictions. The importance of the classification was going to decline as the Central Bank measures were liberalized. An inter-agency committee was presently examining the possibility of abandoning the system of foreign exchange allocation altogether.

### Conclusions

19. The Committee welcomed the recent steps the Philippine authorities had taken to reduce import barriers and the decision of the Philippine government to achieve a more rational allocation of scarce resources and a greater efficiency of domestic industries through the adoption of a programme for the phased reform of the tariff structure and the import procedures.

20. The Committee concluded that the remaining restrictive import measures were justified as a temporary means to safeguard the balance of payments until more fundamental policies became effective. The Committee encouraged the Philippine authorities to further pursue policies that would lead over the medium term to the desired external adjustment and to the gradual removal of the restrictive import measures maintained for balance-of-payments purposes. In this connexion the Committee welcomed the intention of the Philippine authorities to continue pursuing flexible interest rate and foreign exchange policies which, in combination with other domestic policies aimed at achieving the desired external adjustment over the medium term, would help reduce dependence on foreign borrowing and avoid a reduction in the competitiveness of the Philippines' exports.

ANNEX A

OPENING STATEMENT BY THE REPRESENTATIVE OF THE PHILIPPINES

On behalf of the Philippine delegation, I would like to express our gratitude for your cordial welcome on our participation in the work of this Committee for the first time. I would also like to take this opportunity to reiterate thanks to those who extended their assistance in our accession as a contracting party to the GATT.

During the signing of the final accession documents of the Philippines to the GATT, we indicated that we are terminating our provisional membership in favour of a more lasting relationship. Our balance-of-payments consultation now, our first, would hopefully afford an opportunity of our getting to know each other better.

Towards this end, allow me to summarize the developments in the Philippines' balance of payments during the decade of the seventies, as well as the prospects for 1980 as we see them and the policies we have accordingly adopted.

1. Balance-of-payments developments in the seventies

Notwithstanding the decade's average annual growth of 20 per cent in exports and substantial net surpluses in the capital and service accounts, the balance of payments for 1970-1979 resulted in a net deficit of \$267 million.

Total imports for 1970-1979 were \$30 billion, of which more than 50 per cent represent oil (\$6 billion) and capital goods (\$9 billion). Modest balance-of-payments surpluses were realized in 1970-1972, and significant amount of surpluses in 1973-1974 due to the sugar boom but deficits were incurred when the effects of the oil price increases weighed heavily on the economy in 1975-1976 and in 1978 and 1979 when the drop in sugar prices coincided with the successive oil price increases.

The terms of trade during the decade moved against the Philippines. In quantum or volume terms, exports grew more rapidly than imports. Thus, had prices of our imports, particularly oil, increased only to the same extent as the prices of our exports, the balance-of-payments would have reflected a surplus rather than a deficit.

Since January 1970 pronounced shifts have taken place in both the product and market patterns of Philippine exports. Non-traditional products which originally accounted for only 7 per cent of Philippine exports have grown annually by an average of 46 per cent and today account for fully 43 per cent of our export trade. Early in the seventies four fifths of Philippine exports went to the United States and Japan; in 1979, 44 per cent of our exports were consigned to countries in the European Economic Community, Eastern Europe, the Middle East and East Asia.

This two-pronged diversification of our export trade has served to cushion our economy against the adverse effects of depressed demand for some of our exports in specific markets.

2. External debt

In 1970 our external debt service ratio stood at 34 per cent. That year saw the adoption of a systematic debt management programme, the key element of which was the legal provision setting a 20 per cent ceiling on annual external debt service. With the progressive restructuring of existing external debt and longer term new borrowings the debt service ratio has declined to 19 per cent, notwithstanding the annual average increase of 19 per cent in our external debt during the seventies. External debt stands today at \$11.04 billion.

3. Exchange rate

On 21 February, 1970 the peso was freed from its parity of P 3.90 to the United States dollar and allowed to float and seek its level in the foreign exchange market. Since then our currency has moved flexibly and today stands at P 7.55 per United States dollar. In the light of the difficulties that have characterized the balance-of-payments developments during the worldwide instability of the decade, the decline in the external value of the peso may be considered as moderate.

4. Prospects and policies for 1980

Regarding the prospects for 1980 I would like to inform you that the Philippine authorities have adopted a new economic and financial programme aimed at achieving growth and stability. The objectives of this year's programme are the reduction of the deficit in the overall balance of payments, control of inflation and creation of job opportunities in order to reduce unemployment.

The country's balance of payments for the period January-September 1980 reflected an overall deficit of \$200 million. Based on this trend and a re-evaluation of prospects for the remainder of the year, the balance of payments for the whole year of 1980 indicates an overall deficit of \$380 million which is lower than the 1979 deficit.

In the trade account, a sustained growth of exports (31 per cent) will be more than offset by heavier imports. The estimated growth of exports however would have been greater had it not been for the intensification of protectionist measures pursued by some countries which affected the country's non-traditional manufacture of exports, particularly garments.

A major contributory factor to the projected increase in export receipts will be the increase in earnings from sugar as a result of significant improvements in world market prices and the sale of existing sugar stocks.

Copper and non-traditional manufactures exports are expected to expand substantially by 27 per cent and 34 per cent respectively. Shipments of coconut products are, however, expected to fall significantly this year as a result of the soft demand in the world market.

Imports are projected to increase by 28 per cent, largely reflecting higher prices of oil. The oil import bill at \$2.5 billion is expected to account for 30 per cent of total imports in 1980 as against less than one fourth in 1979.

5. Measures adopted to bridge the balance-of-payments gap

The authorities, conscious of the serious implications of the unfavourable balance-of-payments situation have adopted the following measures:

(a) Energy programme

In recent years, the Philippine Government has pursued an active energy policy which envisages steady progress toward greater independence through expanded exploration and development of domestic energy sources as well as through energy conservation. Important progress has also been made in developing alternative domestic sources of energy such as nuclear and geothermal energy production, coal mining, biomass, and hydropower generation.

(b) Industrial programme

The Philippine industrial programme aims at accelerating the growth of industrial output and employment, maintaining the rapid expansion of non-traditional exports and stimulating greater development of industry outside the Metro Manila area.

(c) Export incentives and promotion measures

Philippine export policy is to support direct and indirect export producers/traders through streamlining administrative procedures related to international trade and other appropriate measures. Export industries will also be provided with all reasonable forms of support through financial and other active promotional measures.

We have virtually completed all improvements in export incentives and promotional measures by strengthening and broadening of fiscal incentives for export production and trading; simplifying import and export procedures; liberalizing bonded manufacturing warehouse arrangements; improving and broadening the availability of export financing facilities; and strengthening the institutions that promote exports and international trade.

(d) Tariff reform, liberalization of commodity import procedures and complementary measures

In order to allocate scarce resources more rationally to industries where the Philippines is competitive, the Government has revised the tariff structure and liberalized commodity import procedures. Any adverse near term effects which these reforms may have on revenue collections and the balance of payments will be offset through additional internal revenue measures, among others.

Tariffs across and within sectors, particularly on raw materials and intermediate inputs vis-à-vis finished products are being evened out and the nominal levels reduced, resulting in substantial reduction in the average effective protection rate.

The Government has, in addition, established a phased plan for the liberalization of commodity imports. The liberalization plan covers both non-essential and unclassified consumer goods and other items which are "regulated". In order to ensure that the liberalization plan is carried out expeditiously, complementary measures will be adopted when needed to offset any adverse effects liberalization may have.

I would, however, like to stress that the Philippine authorities would like to maintain the policy of utilizing restrictive import measures to a very limited extent, to phase them out as soon as feasible and to apply them on a non-discriminatory basis. Unfortunately, taking into account the prospects for the remainder of 1980, the maintenance of trade measures has to be considered essential in safeguarding the balance of payments in the context of a set of more general economic policies. It is for this reason that we are seeking GATT balance-of-payments cover for the products listed in Annexes A and B to document BOP/208.

Finally, I would like to express our faith in the sense of objectivity of this Committee and on the sense of solidarity and the understanding of our trading partners.

ANNEX BSTATEMENT BY THE REPRESENTATIVE OF THE INTERNATIONAL MONETARY FUND

The overall rate of growth of the Philippine economy in 1979 was satisfactory and (at 5.8 per cent) was close to the average growth of the preceding three years. However, there was a marked increase in the rate of inflation, from less than 8 per cent in 1978 to almost 19 per cent in 1979.<sup>1</sup> The balance-of-payments deteriorated sharply, with an overall deficit of US\$580 million in 1979 compared to US\$90 million in 1978. Both the price and balance-of-payments performance largely reflected the vulnerability of the economy to external influences. Policies were implemented flexibly during the year and the authorities took several measures to cope with the worsening price and balance-of-payments situation. In particular credit policies were tightened at mid-year, as were controls over budgetary expenditures. Export promotion policies were strengthened through additional fiscal incentives and other measures.

Despite the policy adjustments introduced in the course of the year, the continued deterioration in price performance and in the external payments position led the authorities to undertake a new economic and financial programme aimed at achieving a gradual adjustment over the two years 1980-81. In support of this programme, the Fund, in February 1980 granted a two-year stand-by arrangement in the upper credit tranches with supplementary financing in the amount of SDR 410 million. The adjustment strategy in the programme incorporates demand management policies that aim at bringing about a reduction in the rate of inflation and at gradually restoring balance in external payments. These policies are supplemented and reinforced by measures directed at the supply side of the economy through which the authorities are seeking to sustain the rate of growth near its medium-term average of about 6 per cent.

Recent economic performance has displayed mixed trends. In the first half of this year the authorities succeeded in maintaining good growth momentum in the economy: output in key sectors is estimated to have expanded at somewhat higher rates than in the same period of last year. Also, there was some easing of the rate of inflation. In the year ending June 1980, the consumer price index rose by 17 per cent, compared with 24 per cent in the year to December 1979. For 1980 as a whole, consumer prices, on average,

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<sup>1</sup>As measured by the year-on-year consumer price index.

are expected to be 17 per cent higher than last year. On the other hand, balance-of-payments developments so far in 1980 point to some further weakening. The trade and current account deficits were markedly higher in the first four months of 1980 compared with the same period last year. The official balance-of-payments projections for 1980 envisage an increase in the deficit on current account from US\$1.6 billion or 5.4 per cent of GNP in 1979 to US\$2.1 billion or 5.9 per cent of GNP in 1980. In the trade account, a sustained growth of exports (31 per cent) is expected to be more than offset by higher imports mostly reflecting larger payments for oil imports. Oil imports are now projected to amount to US\$2.4 billion in 1980, almost US\$1 billion more than last year, on a somewhat lower volume. The services account is projected to deteriorate largely due to higher interest payments and little, if any, increase is anticipated in medium- and long-term capital inflows. Substantial recourse to short-term borrowing is expected to offset the deterioration in the current account and an overall deficit of US\$370 million is expected for 1980.

Export earnings have been rising at a high rate in the recent past and there has been a steady diversification of exports toward non-traditional manufactured goods. The Philippines has an exchange system under which the peso floats independently. The United States dollar is the intervention currency. The policy of maintaining a fairly stable peso-dollar rate resulted in a steady depreciation of the trade-weighted nominal effective exchange rate of the peso during 1976-78. With the general strengthening of the United States dollar vis-à-vis other major currencies in 1979, this trend was reversed. The index of the trade-weighted nominal effective exchange rate of the peso rose slightly between December 1978 and June 1980.

Turning to financial policies, the overall budget deficit is projected to rise to 1.4 per cent of GNP this year reflecting a higher rate of growth of total expenditures; in particular, capital outlays through the budget are projected to rise by about 40 per cent. Although total domestic credit is likely to rise by about 20 per cent during the year, the growth in total liquidity will probably not exceed about 12 per cent in 1980. The slower growth in liquidity reflects, in part, the fact that inflation was higher than expected and calls into question the adequacy of the present level of interest rates in encouraging financial savings and helping to reduce the heavy dependence on foreign borrowing. Interest rates have recently been reviewed by a high level committee in the Central Bank. Given the difficult and uncertain external economic environment, flexible use of the interest rate and exchange rate instruments will be helpful in strengthening other domestic policies aimed at achieving the desired external adjustment over the medium term.

Import restrictions for balance-of-payments reasons are administered in the Philippines by the Central Bank through regulations of sales of foreign exchange for import payments. Import items are divided into ten categories

according to the type of good and the degree of essentiality as determined by the authorities. Foreign exchange sales for importation of items under three categories of consumer goods require prior approval by the Central Bank, and are generally tightly restricted or effectively banned. Certain items under the other seven categories also require Central Bank approval, but sales of foreign exchange for importation of such items are less tightly controlled. There are several other regulations governing imports or payments for imports, but these are largely unrelated to the balance-of-payments.

The exchange restrictions imposed by the Philippines have been approved by the Fund under Article VIII of the Articles of Agreement of the IMF.

The authorities intend to undertake a phased liberalization of the exchange restrictions on imports in tandem with a reform of the tariff structure. An inter-agency committee, consisting of the Central Bank, the Ministry of Finance, the Ministry of Industry and the National Economic and Development authority has been appointed to establish a co-ordinated programme of liberalization. In pursuit of this policy ninety-five import items were removed from the restricted categories of consumer goods in the period January-May 1980 and were made freely importable. The Fund welcomes the recent steps to liberalize exchange restrictions on imports and the authorities' intention to continue the liberalization in the context of measures to increase the efficiency of domestic industries.