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GENERAL AGREEMENT ON TARIFFS AND TRADE

1986 CONSULTATION WITH THE PHILIPPINES UNDER ARTICLE XVIII:12(a)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with Paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes, adopted by the CONTRACTING PARTIES on 28 November 1979. (BISD 26S/205).

I. Previous consultations with the Philippines

2. Following the accession of the Philippines to GATT on 1 January 1980, full consultations were held by the Committee with the Philippines in October 1980. In these consultations, the Philippines sought justification under Article XVIII:B for import restrictions on a range of products, import of which was subject either to approval by the Central Bank or to regulations administered by other agencies or committees (BOP/208, Annexes A and B). The Philippines called attention to its plans to phase out such restrictions (BOP/R/115, paragraph 4). In its conclusions, the Committee welcomed the steps which the Philippines authorities had taken to reduce import barriers and the Philippines government's decision to achieve a more rational allocation of scarce resources and greater efficiency of domestic industries through the adoption of a programme for the phased reform of the tariff structure and import procedures. 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, and 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 connection 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 (BOP/R/115, paragraphs 19 and 20).

3. Subsequently, simplified consultations were held with the Philippines in November 1982 (BOP/R/128) and in November 1984 (BOP/R/147). At the 1984 consultation, the Committee noted that the balance-of-payments situation had deteriorated and a number of modifications in the import system had been introduced in response to developments in the economy. Recent policy changes were likely to bring about a further evolution in the situation. For these reasons the Committee decided that full consultations should be held with the Philippines, and these were initially scheduled for December 1985. Following a request by the Philippines for postponement of these consultations the Committee agreed to postpone the full consultation to the autumn of 1986, on the understanding that this consultation would be held on a date early enough

for the report to be submitted to the meeting of the GATT Council which would precede the 1986 regular session of the CONTRACTING PARTIES. (BOP/R/154). However, for technical reasons, it was again necessary to postpone the consultation until December 1986.

II. Policy developments since the last full consultation

4. In 1980, the Philippines started implementing a programme of economic reforms aimed at reducing the high level of domestic protection, stimulating export-oriented production, and achieving a positive rate of economic expansion consistent with a sustainable current account position; this had yielded a deficit equivalent to 5 per cent of GNP in 1979.

5. Trade liberalization and export promotion were major planks of the programme. A five year tariff reform and reduction programme was introduced aiming to reduce the average level of effective protection from 43 to 28 per cent over the period 1980-1985, non-tariff import restrictions on consumer and capital goods were to be gradually liberalized, and export promotion measures were introduced, including fiscal and financial incentives, simplification of export procedures and liberalization of arrangements for in-bond manufacturing. At the same time, the government began a major expansion of public investment aimed at expanding development of substitutes for imported oil, and countering the effects of the international recession. Much of this investment was funded by foreign borrowing.

6. The expected benefits of the programme did not materialize, due partly to adverse external developments and partly because growing budget and balance-of-payments deficits over the period 1980-83 overtook the possible long-term effects of the liberalization measures. In the latter part of 1983, the monetary authorities were forced to call for a moratorium on principal repayments on all debts except for trade credits and ODA loans, in view of the country's low international reserves and insufficient foreign financing to cover the current account deficit and to service maturing obligations. This moratorium will expire on reaching agreement with foreign creditors on all debts subject to renegotiation. This led to the adoption of exchange and import controls including the suspension of the liberalization process, although the tariff reform was completed on schedule.

Measures taken to overcome the crisis

7. In the face of the growing financial crisis, the Philippines government introduced a number of trade and financial restrictions from early 1983 onwards (BOP/248, pp. 12-16). An additional duty on imports was introduced, initially at 3 per cent and subsequently by June 1984 rising to 10 per cent (L/5575, L/5637, L75691). The deposit required from importers on opening letters of credit was increased (to 100 per cent in certain cases), new administrative fees on a number of imports were instituted, and applications to import certain consumer goods in the "unclassified" and "non-essential" licensing categories were suspended. Centralized pooling of foreign exchange receipts was required of all banks, with payments to be approved according to priorities of interest on bank loans, inter-bank loans and trade credits, ODA loans, oil imports and payments for inputs to export industries, raw materials for "vital" domestic industries and feed grains. Measures were taken by the banking sector to facilitate inward transfers by Filipino contract workers overseas; foreign exchange allowances for travel, education etc. were cut, all public sector entities were required to pay shipping

charges on imports in local currency and a 10 per cent excise tax was introduced on all non-merchandise foreign exchange purchases in June 1984. The peso was devalued against the dollar by 8 and 27 per cent in June and October 1983: in June 1984 the peso was floated and has since continued to decline in nominal terms.

8. A new five-year plan for export development, published in mid-1983, laid special importance on increasing exports of tuna, coffee, fruit, meat, garments, furniture, handicrafts, leather goods and footwear. However, related tax and regulatory measures did not encourage exports. New export duties were introduced on coffee and tuna in November 1983, while additional export duties were imposed on wood products, coconut products, pineapple products, bananas, shrimps and prawns; copper exports were restricted in February 1984 and in June 1984 an economic stabilization tax on exports was introduced, initially at 30 per cent, decreasing by five percentage points per quarter.

9. Starting late 1984, many of these restrictive measures were reversed or removed. In October 1984, the additional import duty was reduced to 5 per cent and was subsequently scrapped with effect from 31 December 1985. The special excise tax levied on all non-merchandise foreign exchange and the 30 per cent stabilization tax on exports were also removed in October 1985. The import liberalization programme was resumed, with the lifting of the controls introduced in 1983 on a number of "Non-Essential Consumer" and "Unclassified Consumer" items, as well as on imports of such products as resins, iron and steel, food, fabrics, etc. As of end-September 1986, controls on a further 929 banned or regulated items have been lifted since the resumption of the liberalization programme in 1984. Relatedly, the requirement to seek Central Bank approval for imports of machinery and equipment over US$50,000 per calendar month and per importer was abolished with effect from 1 August 1986. Exchange controls were also eased in October 1984, when the country reverted to the open foreign exchange system which had been set aside with the introduction of the foreign exchange pooling system in November 1983, when domestic banks were required to sell 100 per cent of their foreign exchange receipts to the Central Bank; the ceiling on foreign exchange holdings by commercial banks was gradually liberalized, culminating in its complete removal on 15 August 1985. With the return to the open exchange system, the Central Bank permitted commercial banks to trade in foreign currencies among themselves and to quote buying and selling rates freely. Foreign exchange allowances for travel, education and medical expenses were restored to their original level at the beginning of 1985.

10. Although the authorities introduced in August 1984 a new stabilization plan envisaging, besides debt rescheduling and new borrowing, a reduction in the budget deficit through cuts in public investment and emphasis on completion of ongoing projects, tighter monetary policy and a reorientation of development strategy towards improving agricultural production and marketing, the plan was not fully implemented before the political crisis of late 1985/early 1986. A new development plan to be implemented in 1987-1992 is presently being finalized by the new Government.

11. In October 1985, the Philippines notified the trade and financial measures taken between October 1984 and August 1985 (BOP/253/Add.1). The further measures taken to date have also been notified by the Philippines authorities in an annex to their basic document for this consultation (BOP/269/Add.1).

Economic and trade developments

12. The macroeconomic and trading performance of the Philippines in the early 1980s was very disappointing, compared with that in the 1970s (Table 1). After expanding at an annual average rate of some 6½ per cent between 1970 and 1980, real GNP growth slowed considerably in the early 1980s, and declined in 1984/85: between 1980 and 1985, real GNP per capita fell by 15 per cent. Trade performance in the period 1980-81 was also disappointing; during that period, the terms of trade worsened by some 15 per cent as world prices for many traditional export commodities, in particular those of coconut products, logs and timber, copper and nickel, declined sharply. It is estimated that by 1983, terms of trade losses had amounted to the equivalent of more than half of the deterioration in the current account deficit since 1980. At the same time, the volume of traditional exports declined (Chart 1) and exports of non-traditional products grew less rapidly than expected, due partly to weak external demand and partly to a decline in competitiveness through appreciation of the real exchange rate and high domestic inflation. The trade deficit (on customs clearance basis) increased markedly (Chart 2).

13. During the same period, the dependence of the Philippines' economy on foreign borrowing increased markedly. Much of this debt was contracted on short-term maturities to finance domestic capital formation (which rose from around 20 per cent of GNP in the early 1970s to about 30 per cent in the late '70s and early '80s). By 1982 the share of short-term debt had risen to 46 per cent of total external liabilities (themselves increasing), while total debt service payments had increased to 36.6 per cent of exports of goods and services. Although the high investment/high borrowing policy contributed to rapid economic growth in the late 1970s, this policy proved unsustainable as external economic conditions deteriorated in the early 1980s. The period between 1980 and 1983 thus witnessed a widening current account deficit, from 5.4 to 8.1 per cent of GNP (Table 2).

14. The measures taken by the government in early 1983 to reduce the public sector deficit and to introduce a more realistic exchange rate policy resulted initially in only a small improvement in the trade and current account balances. This was, however, accompanied by a large outflow of short-term capital. The further emergency measures taken from October 1983 led to a sharp decline in imports and a reduction in external imbalances during 1984. Domestic output, particularly in industry, suffered; real GNP fell by some 7 per cent, with manufacturing and construction hardest hit. At the same time, inflation increased rapidly, reflecting the effects of the successive peso devaluations, decontrol of prices, disruption of import flows from the emergency measures, and an expansive monetary policy during 1983. In 1984, due to the sharp fall in domestic demand, import volume fell by nearly 30 per cent. The current account deficit declined to 4 per cent of GNP with the concomitant improvement in the trade balance.

15. Between 1980 and 1984, there were marked changes in the commodity composition of the Philippines' exports (Table 3). Exports of primary products declined from 71 to 61 per cent of the total, with particularly sharp falls recorded for exports of ores and minerals and sugar and sugar preparations. These were largely related to unfavourable world price developments. There was a corresponding increase in the share of manufactured exports, among which exports of electrical machinery (mainly semi-conductors) performed particularly strongly. One the import side, the

commodity composition of trade changed less dramatically. Imports of food products (particularly cereals) and of crude petroleum increased as a share of total imports, although in the latter case the recent decline in world petroleum prices seems certain to reverse this shift. Imports of manufactured goods declined as a share of total imports, due mainly to reduced imports of industrial machinery as the sharp expansion in capital formation of the late 1970s and early 1980s came to an end.

16. As regards the direction of trade, the United States remains the Philippines' largest trading partner, accounting in 1985 for 36 per cent of exports and 25 per cent of imports (Table 4). Japan, the European Communities and certain other Asian countries are important export markets for the Philippines, and these same countries, along with Saudi Arabia and Kuwait, are also the principal sources for its imports. The decline in export value in 1985 reflected reduced sales to practically all of the country's main trading partners; Thailand and China were the most important exceptions to this trend, although exports to Switzerland and Indonesia also grew rapidly from small bases. The sharp fall in imports recorded in 1984 and 1985 was less evenly distributed among the Philippines' trading partners. Imports from the main industrial countries and from Saudi Arabia accounted for a large proportion of the decline in both years, while imports from other countries in the Asian region were much less seriously affected, and in some cases recorded large increases.

17. Tight fiscal and monetary policies introduced in late 1984 (see paragraph 10 above) were maintained in 1985. The rate of inflation was sharply curtailed, but real GNP declined for the second consecutive year. Import volume fell by a further 10 per cent, yet there was only a marginal improvement in the trade deficit because the Philippines' export performance remained disappointing. Exports were adversely affected both by external factors (a slump in world demand for semi-conductors and sharp declines in key commodity prices, especially for coconut products) and by domestic developments (real appreciation of the peso and widespread labour unrest). A small surplus ($8 million) was recorded on the current account, but the overall balance-of-payments position remained weak as the capital account moved into substantial deficit.

18. Preliminary data for the first half of 1986 indicate a further slight strengthening of the trade and current account balances. Export performance appears to continue to be weak, at least in part due to slack demand for many primary commodities on world markets. The value of imports has continued to decline, but as a result this year of the sharp fall in world petroleum prices as well as a lower volume of oil imports, while the value of non-oil imports has increased.

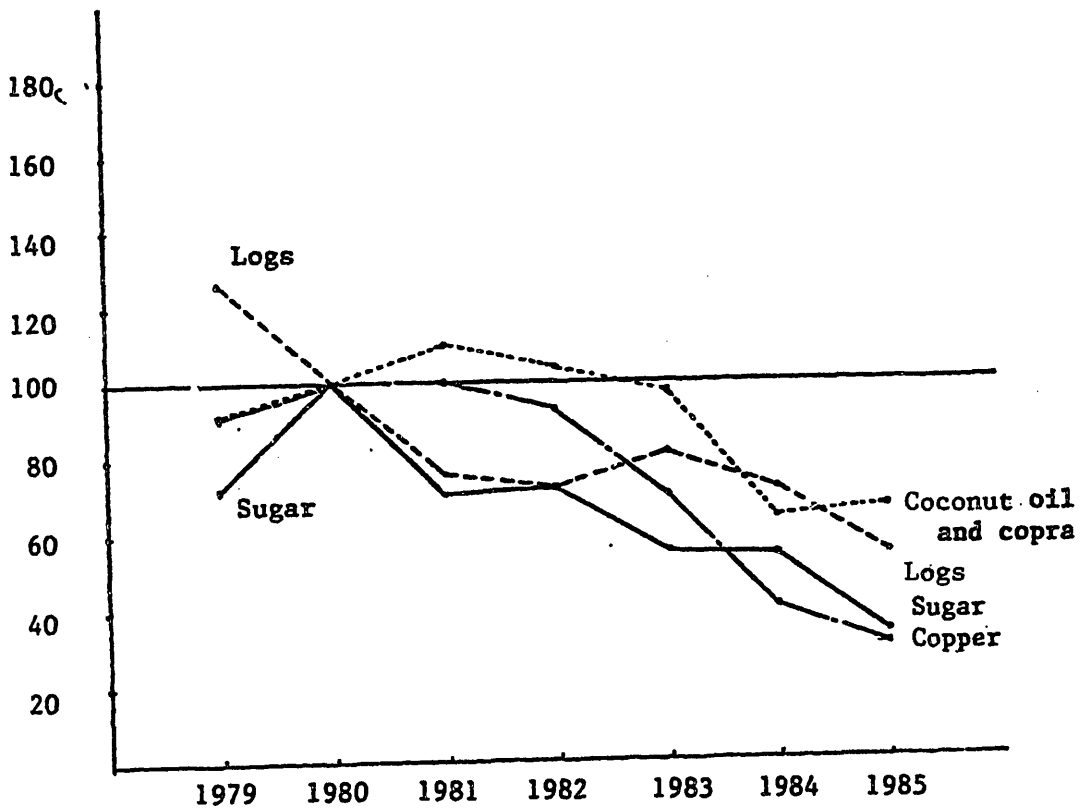
Conclusions

19. The crisis of indebtedness which hit the Philippines in 1983 was in part forecast in the consultations held in the Committee in 1980 (BOP/R/115, paragraph 10). In the light of the severity of the crisis, the interruption of the trade liberalization process in 1983 was perhaps inevitable. During 1984 and 1985, however, the process of reducing trade restrictions has been resumed, while the tariff reform undertaken by the Philippines has proceeded uninterrupted. Current account balance has been achieved in the past eighteen months, at the cost of a severe reduction in imports and declines in GNP. Although exports have increased, many traditional products are affected by low or fluctuating world prices and questions are posed concerning the

future of some non-traditional items such as electronics where foreign demand has recently been weak and which are highly import-intensive. The Government's present aims, however, are to maintain and strengthen the liberalization process.

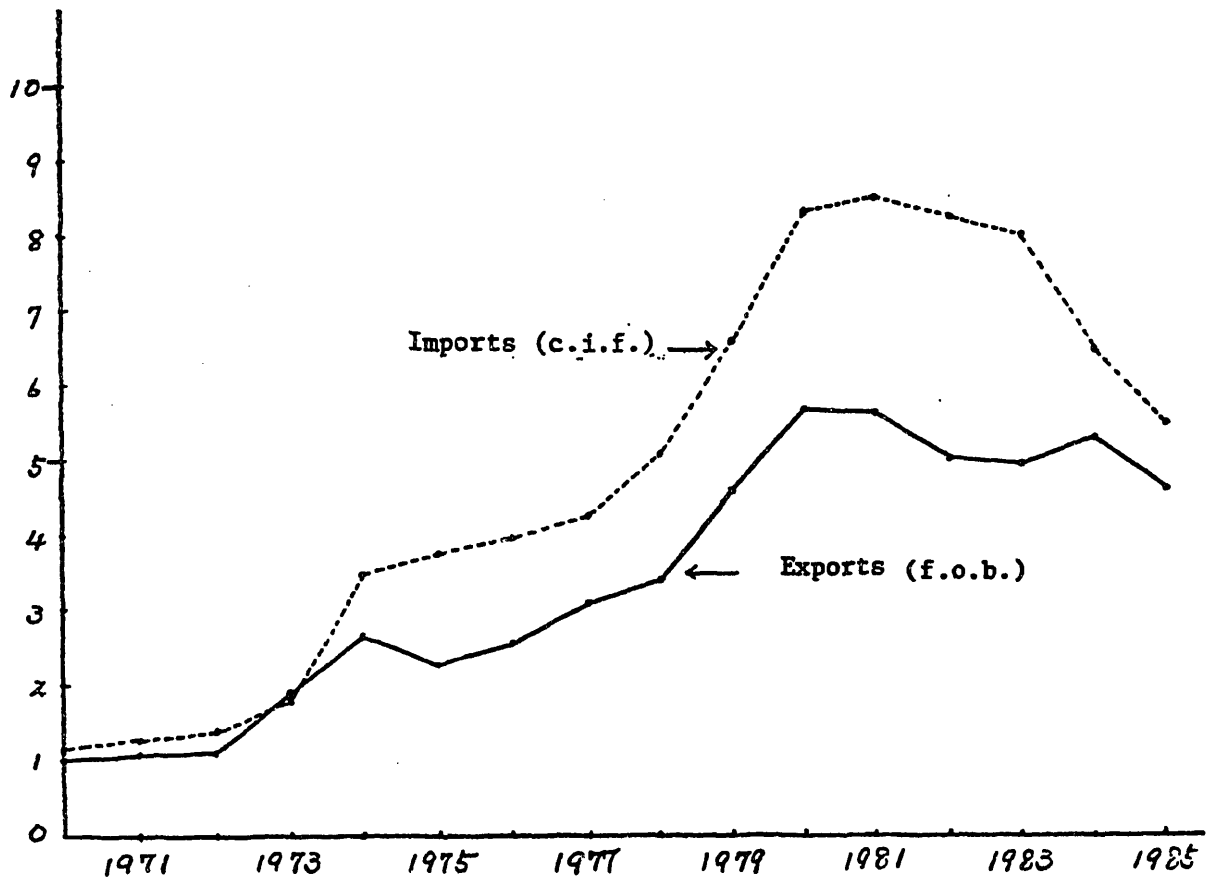
CHART 1 - DEVELOPMENTS OF PHILIPPINES' MAJOR EXPORT COMMODITIES, 1979-1985

(Export volume indices, 1980=100)



SOURCE: See Table 1.

CHART 2 - PHILIPPINES' FOREIGN TRADE, 1970-1985
(billion dollars)



Source: See Table 1.

TABLE 1. - BASIC INDICATORS OF THE PHILIPPINE ECONOMY: 1970-85
(Average annual percentage change)

	Real GNP	GNP deflator	Export Volume	Import Volume
1970-80	6½	13	8½	5½
1980-85	-1	18½	-½	-8½
1980	5.0	15.6	20.6	1.2
1981	3.4	11.0	1.1	-8.0
1982	1.9	8.4	5.6	14.0
1983	1.1	11.6	-5.1	-3.9
1984	-6.8	49.1	-5.9	-28.7
1985	-3.8	17.5	1.6	-10.0

Source: IMF, International Financial Statistics

TABLE 2. - PHILIPPINES' TRADE AND CURRENT ACCOUNT BALANCES
1980-1985

	Trade balance	Current account balance	
	Billion $	Billion $	Percentage of GNP
1980	-1.9	-1.9	-5.4
1981	-2.2	-2.1	-5.5
1982	-2.6	-3.2	-8.2
1983	-2.5	-2.8	-8.1
1984	-0.7	-1.3	-4.0
1985	-0.5	-	-

Source: IMF, International Financial Statistics

TABLE 3. - PHILIPPINES' FOREIGN TRADE BY MAIN COMMODITY GROUP

(Percentage shares)

A. Exports	1980	1984
Total[a]	100	100
Total primary products	71	61
Food	42	44
Animal and vegetable oils	12	16
Fruits and vegetables	8	11
Sugar and sugar preparations	14	9
Raw materials	7	8
Cork and wood	6	6
Ores and other minerals	21	7
Metalliferous ores and metal scrap	21	7
Fuels	1	2
Total manufactures	29	39
Base metals	4	5
Chemicals	2	3
Other semi-manufactures	5	4
Engineering products	4	12
Electrical machinery	(1)	(10)
Textiles	2	1
Clothing	6	7
Other consumer goods	6	7

B. Imports	1980	1984
Total[a]	100	100
Total primary products	44	46
Food	8	10
Cereals and cereal preparations	3	5
Feeding stuffs for animals	1	2
Dairy products	2	1
Raw Materials	3	3
Textile fibres	2	1
Ores and other minerals	1	1
Fuels	32	32
Crude petroleum	27	29
Total manufactures	56	54
Base metals	7	5
Chemicals	11	12
Other semi-manufactures	3	2
Engineering products	32	31
Industrial machinery	(15)	(8)
Electrical machinery	(4)	(9)
Transport equipment	(8)	(5)
Textiles	2	3
Clothing	-	-
Other consumer goods	1	1

[a]Excluding machinery and other articles imported or exported temporarily, or on consignment basis for manufacture of finished products and parts.

Sources: Central Bank of the Philippines.
Annual Report 1984: Statistical Bulletin.

TABLE 4. - PHILIPPINES' FOREIGN TRADE BY PRINCIPAL COUNTRY

($ Billion and percent)

A. Exports

	US $ Billion 1985	Share (%) 1985	Percentage change 1984/1983	Percentage change 1985/1984
World	4.61		8	-12½
United States		35.9	13½	-18½
Japan		19.0	5	-15½
EC(10)		13.6	-12½	-12½
Singapore		5.4	131	-22
Hong Kong		4.0	48	-20½
Malaysia		3.8	10	-2½
Thailand		1.8	-54½	823
China		1.8	169	34½
Australia		1.7	17	-9½
Korea, Rep. of		1.6	-33½	-24
Canada		1.6	16½	-8½
Saudi Arabia		0.8	-21	17½
USSR		0.7	-37	-40
Switzerland		0.7	16½	186
Indonesia		0.4	-72½	120
Total of the above		92.8		

B. Imports

	US $ Billion 1985	Share (%) 1985	Percentage change 1984/1983	Percentage change 1985/1984
World	5.46		-19½	-15
United States		25.1	-6½	-21½
Japan		14.0	-36½	-12
EC(10)		8.3	-26½	-34
Malaysia		7.3	123	10
China		5.4	186	27½
Saudi Arabia		5.2	-49	-35½
Kuwait		4.2	32½	-41½
Korea, Rep. of		4.0	-3½	38
Hong Kong		3.9	-8½	-13½
Indonesia		3.5	12½	-4½
Australia		3.4	-25½	21
Singapore		2.4	-59	6
United Arab Emirates		1.5	-87½	151
Thailand		1.0	1	9½
Brazil		1.0	-42	-12
Total of the above		90.2		

Source: IMF, International Financial Statistics, and Direction of Trade Statistics.