

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

REPORT ON THE 1986 CONSULTATION WITH  
THE PHILIPPINES

1. The Committee consulted with the Philippines on 10 December 1986, in accordance with its terms of reference, pursuant to Article XVIII:12(a) of the General Agreement and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held under the Chairmanship of Ambassador P.-L. Girard (Switzerland). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic document by the Philippines (with Addendum on trade measures taken between 7 November 1985 and 30 September 1986)	BOP/269 & Add.1 & Corr.1
Trade measures taken between October 1984 and August 1985	BOP/253/Add.1
Secretariat background paper	BOP/W/104
IMF reports "Philippines - Recent Economic Developments", dated 26 September 1986, and "Supplementary Information", dated 26 September 1986	

Opening Statement by the representative of the Philippines

3. The representative of the Philippines said that since the Philippines' first appearance before the Committee six years ago, her Government had promoted a more open, less restrictive trade régime with a view to improving the efficiency of domestic industries. Tariff reform, implemented from 1981 onwards, had reduced the average effective protection rate, while import procedures were liberalized and required reserves on margin deposits on import letters of credit reduced in 1982. Progress towards further trade liberalization had, however, been slowed by the foreign exchange crisis which had begun in late 1983, partly due to adverse external developments beyond the authorities' control. International reserves had declined rapidly in an unsustainable external situation. To halt the depletion of foreign exchange reserves and ensure the availability of essential imports, the authorities requested a standstill on loan repayments to foreign banks in October 1983 and adopted a system of exchange controls. All trade-related measures adopted by the Philippines Government during this period had been communicated to the GATT secretariat. Most of them had been lifted since then.

4. The Philippines representative noted that since 1984, measures had been taken designed to stabilize the balance of payments and rapidly reduce the rate of inflation. The first adjustment programme, supported by an eighteen-month standby credit facility from the IMF, rescheduling of maturing

external obligations, new money facilities and a \$3 billion trade facility, comprised the eventual elimination of exchange controls, a more restrictive monetary policy, and a contractionary fiscal policy. Substantial progress was made; the current account moved toward balance in 1985 from deficits equivalent to 8.1 per cent of GNP in 1983 and 3.5 per cent in 1984, and inflation was reduced to 5.7 per cent in December 1985 from a peak of 63.8 per cent in October 1984. However, real output and employment declined during the crisis years 1984-85.

5. The new Government installed in February 1986 aimed to achieve sustained growth and social equity in the long run. While sustaining the progress made in the external accounts and domestic prices, the level of effective demand was to be increased initially through fiscal stimulus, while an employment-oriented and rural-based development strategy had been adopted to tap the country's comparative advantage in agriculture and labour. The new Government's structural reform programme aimed to remove past distortions in the economy and to expose it to international competition in order to improve the level of efficiency. The representative of the Philippines noted that the programme had been supported by the IMF through a new financial package approved in October 1986, totalling SDR 422 million, of which SDR 198 million came from standby credits and SDR 224 million from compensatory financing. It was also expected that negotiations with the Inter-Bank Advisory Committee for the rescheduling of loans falling due between 1987 and 1992, would resume very shortly; talks with the Paris Club would start in early 1987.

6. In 1985, real GNP had declined by 3.8 per cent, almost to the level of 1979. Agriculture was the only growth area during the year. Per capita income fell to its 1975 level. Gross investment and government expenditure fell, while growth in personal consumption expenditure slowed down. Sluggish domestic demand, together with relatively tight monetary and financial policies, contributed to a rapid decline in inflation. Lending and deposit rates fell from over 30 per cent in 1984 to less than 20 per cent in 1985, while the fiscal deficit remained at about 2 per cent of GNP. In the first nine months of 1986 by contrast, real GNP fell by only 0.6 per cent. This indicated that the economic decline of 1985 had bottomed out. The rate of inflation decelerated further to 1.1 per cent following a reduction in domestic oil prices due to the lower price of imported oil. In 1986, monetary policy was more accommodating while interest rates declined further. The pump-priming thrust of government expenditure was reflected in a higher fiscal deficit for the period vis-à-vis the previous year's level, while a community employment and development programme was launched to help generate employment opportunities, particularly in the rural areas.

7. In 1985, external payment arrears of \$2.2 billion were eliminated, a new lending package was negotiated and gross reserves rose. An overall balance-of-payments surplus of \$2,301 million (inclusive of restructuring) or 7.2 per cent of GNP, was achieved. Without restructuring, the overall balance-of-payments position would have shown a deficit of \$545 million. The current account performed strongly, reflecting increases in service receipts and reductions in imports; exports, however, fell by 14 per cent after rebounding strongly in 1984. Weak demand and soft prices in world markets affected earnings from traditional exports such as coconut products, sugar, forest products and copper concentrates, while electronics, the country's single largest export, suffered a significant decline following the slump in the demand for semi-conductors. Earnings from some non-traditional manufactured commodities could have expanded further, but for protectionist

measures taken by some leading trading partners. Imports remained depressed due to sluggish domestic economic activity and soft demand for certain import-dependent exports, while the value of oil imports fell with a sharp decline in price and volume. The net terms of trade remained adverse to the Philippines. Higher receipts from travel and increased foreign government expenditures in the country raised services receipts while a general downtrend in international interest rates, lower payments for merchandise freight, insurance, and other transportation helped in reducing services payments. Inclusive of net transfers, the current account showed a deficit of \$77 million.

8. The non-monetary capital account surplus increased from \$1,205 million in 1984 to \$1,685 million in 1985. The key factor behind this improvement was the restructuring of some \$2,846 million on foreign obligations. If rescheduled debts were not considered, the capital account would have yielded a deficit of \$1,161 million.

9. During the first nine months of 1986, balance-of-payments developments paralleled those in 1985. The preliminary overall surplus amounted to \$720 million inclusive of restructuring (a deficit of \$279 million without restructuring). Merchandise trade remained in deficit although imports fell and exports increased slightly. A net surplus in the services account yielded a current account surplus of \$928 million.

10. Gross international reserves stood at \$1,710 million at end-September 1986, equivalent to about 2.6 months of the country's imports of goods and services, a marked improvement from the levels of \$886 million at end-December 1984 and \$1,061 million at end-December 1985. The Government aimed to achieve and maintain a level of reserves equivalent to 3-3.5 months of imports of goods and services. Total foreign exchange liabilities as of end-September 1986 stood at \$27,798 million, 5.9 per cent higher than the end-December 1985 level, due mostly to revaluation. Of this total, about 20 per cent were short-term liabilities with repayment periods of one year or less while the remaining 80 per cent had original maturities of over one year, compared to 37 and 63 per cent respectively in 1983. The exchange rate of the peso vis-à-vis the United States dollar generally remained stable, contrary to the widely-held belief that the exchange liberalization which started in mid-1984 would lead to a sharp depreciation of the peso.

11. The Philippines representative said that for 1987, the current account was expected to show a moderate deficit, with increased imports in order to achieve growth of 6-7 per cent and to provide for interest payments on the country's external obligations. The trade deficit was expected to widen, although exports were projected to expand by 8 per cent. An increase in services payments was expected to be offset by higher interest income and receipts from tourism. Before restructuring and new credits, the capital account deficit should be lower, mainly because of increased utilization of trade credits. Rescheduling of external obligations and availability of new money, particularly from official creditors, were expected to cover the payments shortfall and allow for a further increase in international reserves. The Philippines Government continued to attach the highest importance to achieving higher productivity and greater competitiveness in both the external and domestic markets, through the expansion and mobilization of domestic savings, the improvement of education and upgrading of skills, the promotion of domestic competition and the maintenance of a flexible exchange rate system that would encourage exports, particularly of non-traditional and agro-based products.

12. The representative of the Philippines called attention to the following measures which had been implemented since 1983 to alleviate the difficult external payments position of the Philippines: (a) a moratorium on principal repayments on foreign debt (excluding trade-related credits and official development assistance); (b) the liberalization in October 1984 of controls adopted in November 1983 on current payments and of the pooling of foreign exchange receipts in the Central Bank; (c) greater efforts to promote exports, combined with a cautious monetary policy to sustain the progress made in the external sector and on the inflation front. Export procedures had been simplified for most commodities. All export taxes except that on logs, and the export ban on copra had been abolished. Monopolies in coconut, sugar, meat processing, grains and fertilizers had also been dismantled, thus restoring free trade in all these commodities. In addition, trade policy reforms had so far resulted in the removal of import licensing restrictions, alignment of indirect taxes on domestic and imported goods, and a tariff reform which had reduced the average tariff rate from 43 per cent in 1981 to 28 per cent in 1985 and had lowered the maximum tariff rate from 100 to 50 per cent. The liberalization of import licensing requirements on non-essential (NEC) and unclassified consumer (UC) goods and other items had meant that from 1 January 1981 to 30 September 1986 a total of 1,936 items had been deregulated. The Philippines representative said that the remaining items covered by the import liberalization programme, not yet liberalized, numbering around 300, were scheduled for phasing out not later than April 1988, when the Philippines Government expected fully to implement the programme. These commodities, which accounted for about 5 per cent of total imports in 1985, covered mainly intermediate products such as synthetic resins, textile yarns and thread, iron and steel products as well as consumer goods such as fabrics and garments, exotic fruits and various non-essential items. In addition, effective 1 August 1986, the requirement to seek Central Bank approval for the importation of machinery and equipment, aircraft and vessels over \$50,000 per calendar month for each importer had been abolished.

Statement by the representative of the International Monetary Fund

13. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in the Annex.

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

14. Members of the Committee expressed their appreciation for the complete and high quality documentation and statement provided by the Philippines, which had provided the Committee with a considerably clearer picture than hitherto of the Philippines' balance-of-payments position, as well as its trade, financial and monetary policies.

15. Some members asked for clarification concerning the exchange rate policy followed by the Philippines, particularly whether the peso was to be left entirely free to float in relation to the United States dollar. Further information was also sought regarding the long-term objectives of policy towards the structure of external debt, efforts being made to promote exports and the rôle, importance and outlook for the services balance in the current account.

16. In reply, the representative of the Philippines noted that whereas under the previous Government, tight monetary policy carried out through the

issuance of Central Bank bills had the effect of supporting the exchange rate, current policy since February 1986 was to let the market determine the exchange rate. Intervention by the Central Bank was now only made to smooth seasonal fluctuations in the exchange rate, which was not protected in any way. No new Central Bank bills had been issued and some had been withdrawn. As noted in the Philippines' statement, the rate of the peso against the United States dollar had remained stable or even appreciated slightly since February 1986 despite the non-intervention policy. With regard to the debt profile, the government's main objective, in negotiating with its creditors, was to reduce the debt servicing burden and the overall ratio of external indebtedness to GNP. The latter was expected to be over 90 per cent in 1986; however, it was hoped that, with restructuring, the ratio of debt service to GNP could be reduced from 5.8 per cent to 2.8 per cent and that of total external debt to GNP to 62 per cent by 1992. This would improve the Philippines' ability to grow out of debt.

17. Export promotion efforts were closely linked to the trade liberalization being undertaken by the Philippines. The aim was to maintain and expand export competitiveness through an appropriate level of exchange rate, liberalization of imports (including in particular inputs for potential export sectors) and minimizing governmental intervention in industry. In reply to a question from another member on diversification of export products and markets, the Philippines representative noted that there had recently been encouraging indications. Diversification of export production could arise both from development of market opportunities and liberalization of conditions for expansion of export production. The Government proposed to provide a comprehensive information service on export possibilities.

18. As far as the services sector was concerned, it was difficult to predict the future trend of foreign exchange earnings. The Philippines representative observed that income from travel and tourism had not declined and were expected to increase.

19. One member asked for information on the measures taken or to be taken in future by the Philippines authorities, to encourage foreign investment. The representative of the Philippines noted that an active programme of sales of stocks of formerly Government-owned corporations was in hand, including the conversion of such corporations' debt into equity. Through this programme, which was already showing success, the authorities sought to encourage greater private participation in the economy. The Government's general policy was to encourage direct foreign investment rather than long- or medium-term loans: to this end, investment legislation and procedures had been consolidated in the omnibus Investment Code of 1986, a "one-stop" information system on all aspects of foreign investment had been introduced in the Ministry of Trade and Industry, and certain additional investment incentives to encourage greater employment and provide fiscal stimuli had been introduced. The representative of the International Monetary Fund noted, in this connection, that the scheme for conversion of debt into equity referred to above gave rise to the only remaining exchange restriction subject to Fund jurisdiction.

#### System, method and effects of the restrictions

20. A number of questions were asked on the types and extent of import or foreign exchange measures remaining in application, and the degree to which these were justified for balance-of-payments reasons. It was noted that, in

paragraph 53 of the Philippines' basic document (BOP/269), reference had been made to import licensing, restrictions on sales of foreign exchange for commodities classified as Non-Essential Consumer (NEC) and Unclassified Consumer (UC) items, and compulsory margin deposits equivalent to 25 per cent of the value of letters of credit to be opened. Members asked whether all these measures were for balance-of-payments purposes, and whether these were the only such measures. Information was also sought on whether items subject to import licensing were also those subject to foreign exchange restrictions. Clarification was sought as to whether other rates of margin deposits than 25 per cent were applied. The Philippines authorities were invited to notify a complete list of products remaining subject to import licensing and to specify the justification of particular restrictions under the relevant Articles of the General Agreement. Questions were also posed concerning the practice applied whereby payment of tariffs is to be made at the time of opening letters of credit, rather than at the time of importation, and concerning the alignment of indirect taxes mentioned in paragraph 51 of the Philippines' basic document. The justification of the maintenance of the export tax on logs was also queried.

21. In reply, the representative of the Philippines stated that all foreign exchange restrictions introduced in 1983, including those on NEC and UC items, had now been liberalized. Other restrictions on foreign exchange holdings by commercial banks, dating from before the 1983 crisis, had also been liberalized in August 1985. Thus, the only import restrictions remaining in existence for balance-of-payments purposes were those operated through the import licensing system, which now covered some 300 items representing, as noted in the opening statement, about 5 per cent of imports. Moreover, not all items covered by import licensing were justified under balance-of-payments reasons; a number were maintained for reasons justifiable under other GATT Articles such as health, national security, etc. The Philippines authorities would provide GATT with a complete list of items remaining under import licensing, including the timetable for liberalization. Remaining import restrictions justified for balance-of-payments reasons would be phased out by end-April 1988.

22. Rates of margin deposit on letters of credit could vary between 25 and 70 per cent of the value of the letters of credit. Imports by export producers, government institutions and essential industries were exempted. The Philippines representative stated that the deposit requirements were not a governmental measure, but were instituted by the Bankers' Association of the Philippines. The Central Bank had imposed reserve requirements for such deposits in order to protect importers. These provisions were currently under review.

23. The Philippines representative called attention to the tariff reform undertaken between 1981 and 1985 which had significantly reduced the average rate and spread of tariffs. Advance payment of tariffs at the time of opening letters of credit was a fiscal measure aimed at improving tax collection. In respect of indirect taxes, the Sales Tax Reform Decree of 1985 had eliminated all differential mark-ups applied for sales tax purposes between local and imported goods. The rates of sales tax on local and imported products had also been unified, except for those mentioned in paragraph 51 of the basic document (cigarettes and automobiles). The alignment was consistent with the Decision of the CONTRACTING PARTIES on 27 November 1984 (BISD 31S/7), under which the Philippines had been given until 31 December 1989 to make such alignments. With regard to logs, the export tax remained in existence primarily for ecological reasons.

### Conclusions

24. The Committee noted that since the last consultation, the Philippines had pursued a balanced package of domestic and external adjustment policies, including fiscal and monetary measures, trade and exchange control liberalization and flexible exchange rate policies, which had led to a considerable improvement in the balance-of-payments situation. It noted that restructuring of the external debt had also made a major contribution to this evolution. The Committee observed that remaining import restrictions covered by the present programme were limited in scope and welcomed the Philippines' undertaking to notify all such remaining measures in detail to GATT.

25. The Committee encouraged the Philippines authorities to maintain their adjustment, liberalization and flexible exchange rate policies. It expressed its hope that these policies would bring about a sustainable improvement in the balance-of-payments situation of the Philippines. The Committee recognized the importance to the Philippines of continuing external financial support. The Committee looked forward to the phasing out of remaining restrictions according to the timetable set out by the Philippines authorities and mentioned in paragraph 21.

ANNEXStatement by the Representative  
of the International Monetary Fund

Since the beginning of this decade, the Philippine economy has been adversely affected by the prolonged international recession, the consequent deterioration in the terms of trade, and a steadily growing external debt and interest burden. Until 1983, import demand was maintained at unsustainable levels through domestic policies which supported an ambitious investment program. As the domestic savings effort remained weak, investment spending was financed increasingly by foreign borrowing on relatively short maturities. Although programs were introduced from 1980 to liberalize the trade regime and the financial system and to improve export and investment incentives, the pace of their implementation proved to be too slow to reverse the growing underlying domestic and external imbalances. Annual growth in real GNP, which had averaged 6 percent during 1975-80, slowed to only 2 percent during 1981-83, while inflation accelerated beginning in 1979. Between 1980 and 1983, the external current account deficit widened from 5 percent of GNP to 8 percent of GNP, short-term external debt rose to over 40 percent of total debt, and the debt service ratio increased sharply to 33 percent. Sizable external payments arrears were accumulated, while gross reserves fell to a critical level.

These developments prompted the authorities to seek, in October 1983, a standstill on maturing principal payments. Simultaneously, exchange and trade restrictions were sharply intensified. A centralized system of foreign exchange surrender and allocation to priority uses was established. Imports of consumer goods were severely restricted by the requirement of prior approval, while imports of specified products were suspended. Nevertheless, substantial external arrears accumulated, even on payments which the authorities considered to be of the highest priority. The tightening of exchange and trade controls, coupled with the difficulties encountered in obtaining traditional trade financing arrangements, led to a halving of the external current account deficit, to 4 percent of GNP in 1984. This, in turn, contributed to a drop in output and, in conjunction with continued rapid growth in credit, to an acceleration in inflation. Real GNP declined by close to 7 percent in 1984, while the 12-month rate of inflation peaked at over 60 percent by the end of the third quarter. Notwithstanding the introduction of new revenue measures, the national Government budget continued to be a strain on monetary policy, while public financial institutions required increasing amounts of Central Bank resources to meet maturing guarantees on external obligations of the private sector.

In the latter part of 1984, major adjustment measures were progressively implemented, including the tightening of monetary policy to contain domestic demand and reduce inflation, and a reform of the exchange system to strengthen the external balance and eliminate payments arrears. The new exchange system announced in October 1984 involved a float of the exchange rate, and the abolition of the administrative allocation and surrender requirements. The priority system of foreign exchange allocation for imports was abandoned, and imports were classified into freely importable, liberalized, regulated, prohibited, and banned categories. The adjustment effort, which also incorporated structural changes in a number of areas, notably in agriculture, was supported by an 18-month stand-by arrangement with the Fund beginning in December 1984. Additional external assistance was provided in the form of restructuring of debt to official creditors, as well as a commercial bank financing package consisting of debt restructuring, a revolving short-term trade facility, and new loans in the amount of US\$925 million.

Monetary policy remained tight for most of 1985, and interest rates turned sharply positive in real terms. The national government budget required increased domestic financing, reflecting revenue slippages as well as failure to sufficiently curtail expenditure. However, the consolidated public sector deficit declined as a result of an improved performance of the major nonfinancial public corporations. Monetary restraint contributed to the sharp reduction in inflation to under 6 percent by end-1985, but was also instrumental in the further decline of real GNP by close to 4 percent. Other important factors contributing to the poor growth performance were delays in implementation of key structural reforms, erosion of investor confidence with increased political uncertainty, and an unfavorable international environment which constrained export growth. In particular, further import liberalization of over 1,200 items planned for the end of 1985 was delayed. The decline in economic activity was reflected in a further sharp drop in imports which, in conjunction with larger net service receipts, allowed the external current account to move into balance in 1985. External payments arrears were eliminated by end-1985 as scheduled, while gross official reserves were replenished to over US\$1 billion. A 4-year tariff reform program which included lowering of maximum and average tariff rates, was completed in 1985. The across-the-board import surcharge, first introduced in April 1983 at a rate of 3 percent and subsequently raised to 10 percent, was abolished in December 1985.

Economic developments during the first quarter of 1986 were strongly influenced by the Presidential elections held in early February. Excessive national government expenditure in this period, coupled with revenue shortfalls, resulted in a national government deficit of P 10 billion, or close to one third of the deficit presently projected for the year. The financing of the deficit necessitated heavy recourse to Central Bank resources, which were further taxed by increased demands

of the Philippines National Bank following large deposit withdrawals triggered by the political uncertainty. These developments contributed to a sharp expansion in reserve money, which was brought under control following the change of government. The gradual return of confidence also resulted in a reduction in interest rates from the peak levels reached in early February. On the external front, the return of confidence was reflected in a further build-up of gross reserves to US\$1.7 billion by the third quarter of 1986. The sharp depreciation of the peso (from P 19 per U.S. dollar to P 22) in the period immediately after the election was followed by an appreciation (to about P 20.5 per dollar). On average, however, the Philippines' international competitiveness, as measured by the real effective exchange rate of the peso, was maintained at or slightly above, the level of October 1984, when the floating rate system was inaugurated.

Following the elections, the new government embarked on a comprehensive economic program supported by an 18-month stand-by arrangement with the Fund which became effective on October 24, 1986. The program focuses primarily on addressing longstanding structural weaknesses and creating a stable environment for sustained growth. A temporary fiscal stimulus in the second half of 1986, stemming from an increase in public investment and maintenance spending, will initiate the economic recovery. Private activity is expected to sustain and strengthen growth in 1987 in response to an improved economic environment resulting from the full implementation of wide-ranging reforms. In line with these developments, the national government deficit is projected to decline from 4.4 percent of GNP in 1986 to 2.4 percent in 1987, which will also reflect improved revenue mobilization. The structural policies are expected to reduce the consolidated public sector deficit, thereby easing pressures on domestic financial resources and allowing a reduction in interest rates which will, in turn, support the private sector recovery. Monetary policy during the program period is intended to accommodate the anticipated recovery, without rekindling inflation which is projected to remain at around 5-6 percent. The external current account is projected to be in a slight surplus in 1986 and to record a deficit of around 1 percent of GNP in 1987. However, in view of the Philippines' large amortization obligations, sizable external financing gaps will have to be filled through further reschedulings by private and official creditors and an acceleration of disbursements on existing commitments.

The major structural changes introduced with the program pertain to tax reform, import liberalization, rehabilitation of the public financial institutions, and agricultural reforms--notably in the traditional sugar and coconut sectors. In broad terms, the changes are aimed at reducing government intervention in the economy, reorienting the development process toward the rural and export sectors, and promoting a more outward looking and competitive economy through trade liberalization and the continuation of flexible exchange rate policies.

In the area of trade policy, the liberalization of the over 1,200 items--equivalent to about 8 percent of 1984 imports--originally scheduled for end-1985 began in earnest in May 1986. By end-September 1986, 929 of these items were liberalized, comprising mainly raw materials and intermediate goods not produced locally. All exchange restrictions subject to Fund jurisdiction that were introduced after October 1983 have now been abolished. Looking ahead, the authorities intend to liberalize, by April 1988, the remaining items from the previously agreed liberalization schedule.

The Philippines' adjustment program incorporates a comprehensive set of measures, the timely and full implementation of which will support the envisaged economic recovery and consolidate the external gains recently achieved. The success of the program will depend crucially on the strength of the private sector response to the favorable investment climate created by the institutional and structural reforms, which have been formulated in close collaboration with the Fund and the World Bank. Externally, the balance of payments will need to be strengthened through the creation of an environment conducive to the growth and diversification of exports over the medium term, including continued exchange rate flexibility. The Fund welcomes the maintenance by the Philippines of an exchange system which is almost free of restrictions on payments and transfers for current international transactions, and the recent steps to liberalize import restrictions; the remaining import restrictions are largely designed to protect local industries or to safeguard health and safety standards and national security. The Fund encourages the authorities to pursue further their trade liberalization and tariff reform efforts which will be essential to promote the strong export growth required to support a sustained economic recovery and a lasting restoration of balance of payments viability. In this connection, the Fund welcomes the authorities' commitment to further liberalize the remaining import restrictions.