GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/W/137

4 March 1991

Limited Distribution

Committee on Balance-of-Payments Restrictions

CONSULTATION WITH THE PHILIPPINES (SIMPLIFIED PROCEDURES)

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 (BISD 26S/205-209) to assist the Committee in taking the decision referred to in paragraph 8 of that Declaration. It updates the paper prepared for the 1988 consultation (BOP/W/119).

I. Previous consultations with the Philippines

2. The Philippines has held five consultations in the Committee since its accession to GATT in 1980 (1980, 1982, 1984, 1986 and 1988). At the last full consultation, held on 10 December 1986, the Committee noted that 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. 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. The Committee looked forward to the phasing out of remaining restrictions according to the timetable set out by the Philippines authorities.

3. At the 1988 consultation, the Committee agreed to recommend a simplified consultation in 1990. However, it noted that the opportunity of requesting a full consultation under Article XVIII:12(a) would be available in the event of changes in trade policy (BOP/R/179).

II. Subsequent notifications by the Philippines

4. Following the 1988 consultation, the Philippines notified, in document BOP/269/Add.2, a list of 290 items (at the 7-digit Philippines tariff line level) scheduled for liberalization by April 1988. Details of the Central Bank Circulars containing the import liberalization measures introduced between January 1987 and April 1988, as well as seven further Circulars setting out import liberalization measures undertaken between December 1988 and February 1990, were notified in August 1990 in document L/6719.

III. Philippines' trade and exchange system: evolution since the last consultation

(a) Import restrictions

5. All merchandise imports are allowed with the exception of certain commodities which are regulated or restricted for reasons of public health, national security, international commitments, and development and rationalization of local industries' needs. Imports are classified into freely importable commodities, prohibited commodities, nonessential consumer (NEC) and unclassified consumer (UC) goods, regulated commodities, and liberalized commodities.[1]

6. Freely importable and liberalized commodities may be imported without restriction. Commodities classified as NEC or UC goods require prior approval by the Central Bank before importation, while importation of regulated commodities requires clearance and permits from various government agencies but does not need prior CB approval. Prohibited imports cover products originating from South Africa and commodities such as onions, potatoes, garlic, cabbages, coffee, used clothing and rags, and toy guns. Some goods which are currently in the prohibited list will, however, be liberalized under the Government's Import Liberalisation Programme (ILP).

7. Between mid-1986 and April 1988, 1,229 tariff line items were liberalized under Phase I of the import liberalization programme. Under phase II of this programme, 557 items are scheduled for liberalization by mid-1994. Up to February 1990, 234 lines had been liberalized, leaving 323 items subject to quantitative restriction, including passenger cars, motorcyles and consumer electronics which are protected under specific industry rationalization programmes. After the completion of Phase II, about 116 items, including rice and corn, firearms, live animals, and chemicals, will remain restricted for health and security reasons as well as to provide remaining protection for goods falling under the rationalization schemes. The items scheduled to be liberalized under Phase II of the ILP, and those remaining restricted, are listed in the Annex.

(b) Exchange regulations affecting trade

8. The Philippines does not maintain margins in respect to foreign exchange transactions, and its exchange rate is market-determined.[2] The Central Bank participates in the foreign exchange market to service its own obligations and those of the National Government, and to maintain orderly conditions in the exchange market. The exchange system is free of restrictions on payments and transfers for current international

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[1] Liberalized commodities are those that were formerly banned but may now be imported without prior approval by the Central Bank.

[2] The exchange regulations and exchange system of the Philippines are described by the IMF in the 1990 Annual Report on Exchange Arrangements and Exchange Restrictions.

transactions, with the exemption of a limitation on dividend payments for four years on "non-priority" investments undertaken under the debt-to-equity conversion scheme. There are also limits on foreign exchange allocations for travel, education and certain other services; however, exemptions are readily granted for bona fide applications. Since October 1990, banks, in agreement with the Central Bank, have restricted the opening of letters of credit for non-oil imports to 80 per cent of the average foreign exchange receipts in the first seven months of 1990. This restriction was further extended in November 1990 to cover open account obligations. Banks have also established an informal queing system for allocating foreign exchange to importers, which has given preference to exporters and established bank customers.

(c) Import duties and preshipment inspection

9. After the comprehensive Tariff Reform Programme implemented by the Philippines between 1981 and 1985, some further adjustments were made in 1988 and 1990. In March 1989, tariffs on cement products were lowered and in July 1989, import duties were reduced, and on 26 December 1989, import duties on these articles were totally suspended. On 20 August 1989, import duties were reduced and in some cases eliminated on certain raw materials and intermediate goods, including fertilizers, iron and steel, and man-made fibers. Duty reductions/elimination were affected on some 86 products including basic raw materials such as rattan poles, foundry coke, logs and lumber and pig iron.

10. On 23 January 1990, National Emergency Memorandum Order No. 8, modified the rates on some 76 articles, mostly through tariff reduction. Among the articles with reduced rates are agricultural and dairy machineries and parts thereof; medicaments; electrical ignition for internal combustion engines; piston engines for power tillers; air and oil filters for internal combustion engines. Originally intended to appy for a limited period, the modified rates prescribed under this Memorandum Order still remain in force up to the present by virtue of EO No. 404 issued on 8 June 1990.

11. In July 1990, the Government announced the broad outline of a new simplified tariff schedule that will place a 3 per cent minimum tariff duty on all imports, increasing to maxima of 10 per cent on raw materials, 20 per cent on intermediate goods, and 30 per cent on finished goods. Goods liberalized from QRs will, however, bear a 50 per cent duty. This tariff schedule, put in place through the issuance of Executive Order No. 413 dated 19 July 1990 was, however, held in abeyance subject to the further review of both the government and the private sectors.

12. Implementation of the Comprehensive Import Surveillance Scheme (CISS) was pursued with the Société Générale de Surveillance (SGS) as the designated inspector. This preshipment inspection requirement currently

applies to imports coming from 10 countries.[3] The minimum value of shipments that require SGS inspection was reduced to $500. There is at present a proposal to globalize the country coverage of SGS inspection.

IV. Economic and trade developments

Introduction

13. The real GDP of the Philippines grew by 6½ per cent in 1988 and 5½ per cent in 1989. Domestic demand was stimulated by several wage increases and by monetary expansion, particularly in 1989. Investment activity was buoyant, helped by a booming construction sector, and industrial capacity grew in response to increasing aggregate demand. Estimates for 1990, however, show a marked decline in real GDP growth to 2½-3 per cent.

14. The consolidated public sector deficit increased in 1988 and 1989 to 3.1 and 4.1 per cent of GNP respectively, despite a decline in the central government deficit from 2.8 to 2 per cent of GNP. Both deficits are estimated to have increased their share of GNP further in 1990.

15. In the first half of 1989 monetary expansion accelerated; the authorities attempted to slow money growth in the third quarter of 1989. Inflation has increased since 1986. In addition to monetary factors, upward pressure on the price level was exerted by rising oil prices, by government wage increases and by the 1989 Minimum Wage Act (R.A. 6727) which raised statutory minimum wages by an estimated average of 30 per cent.

16. The current account deficit dropped from 1.3 per cent of GNP in 1987 to 1 per cent in 1988. A deterioration in the terms of trade in 1989, mainly as a result of rising oil prices, was partly responsible for the sharp increase in the current account deficit to 3.3 per cent of GNP. The overall balance of payments surplus fell from US$650 million in 1988 to US$451 million in 1989. International reserves (excluding gold) rose to some US$1.4 billion by the end of 1989, following the conclusion of a rescheduling arrangement with Paris Club creditors which covered rescheduling of the prinicpal and interest on various debts, as well as interest capitalization. The Philippines' total external debt was estimated at US$27.6 billion at the end of 1989, according to the Central Bank of the Philippines.

Aggregate supply and demand

17. The growth rate of real GDP in the Philippines peaked at 6½ per cent in 1988, falling to 5½ per cent in 1989 and to an estimated 2½ per cent in

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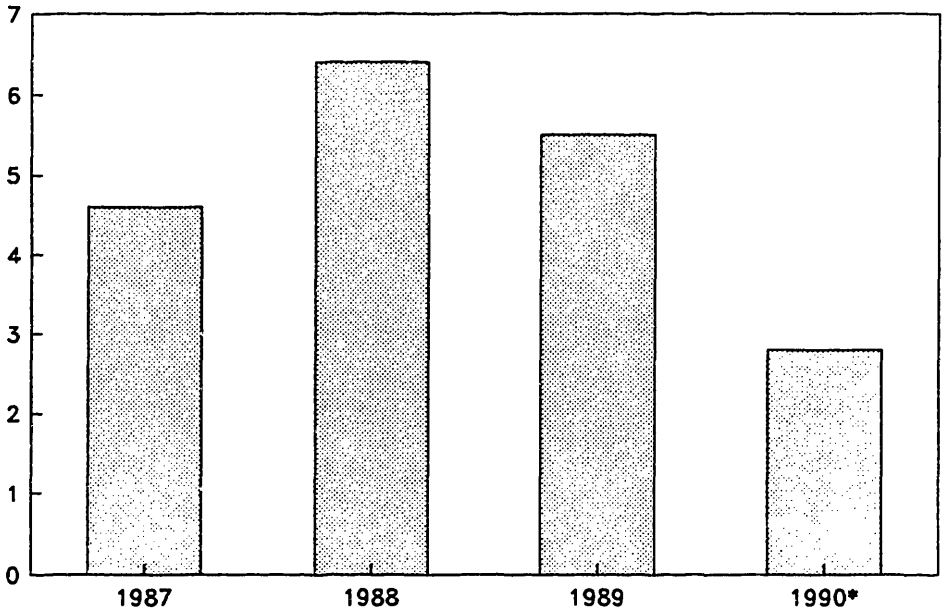
[3]Countries covered by preshipment inspection are Brunei, Indonesia, Japan, Hong Kong, Macao, Malaysia, Singapore, South Korea, Taiwan and Thailand.

1990. Real gross domestic investment led this pattern, slowing from 33 per cent growth in 1987 to under 15 per cent in 1989 and to an estimated fall of 0.4 per cent in 1990. The main sources of private investment were the construction sector and expansion of industrial capacity. However, public expenditure, especially in power generation, was a significant element in total investment.

Graph 1 – Philippines – Real GDP
(Annual percentage change)



Source: IMF.
*Preliminary estimate.

18. Recovering after severe drought and typhoon damage in 1987, output of agriculture, fisheries and forestry grew by 3.6 per cent in 1988. These sectors grew by 4.3 per cent in 1989 due, in part, to better weather conditions and also to continued government efforts to increase productivity (especially for rice, corn and coconuts). Estimates for 1990, however, point to a sharp decline in growth for the sector, to some 2.2 per cent, largely owing to the effects of severe drought in the first half year.

19. In 1989, the Philippines' industrial output grew at about 7 per cent. The most dynamic sector was construction, with real growth of just under 14 per cent, led by private construction partly supported by government finance. Following institutional reforms to facilitate the execution of government projects, public investment in infrastructure increased significantly in 1989. Data for 1990 show a considerable downturn in construction, with the growth rate of private construction expenditure down by 44 per cent and a fall in the real value of public sector construction. Continuing its recovery from the 1986 recession, manufacturing output grew at an average rate of 6.3 per cent in 1989. Growth was broadly based,

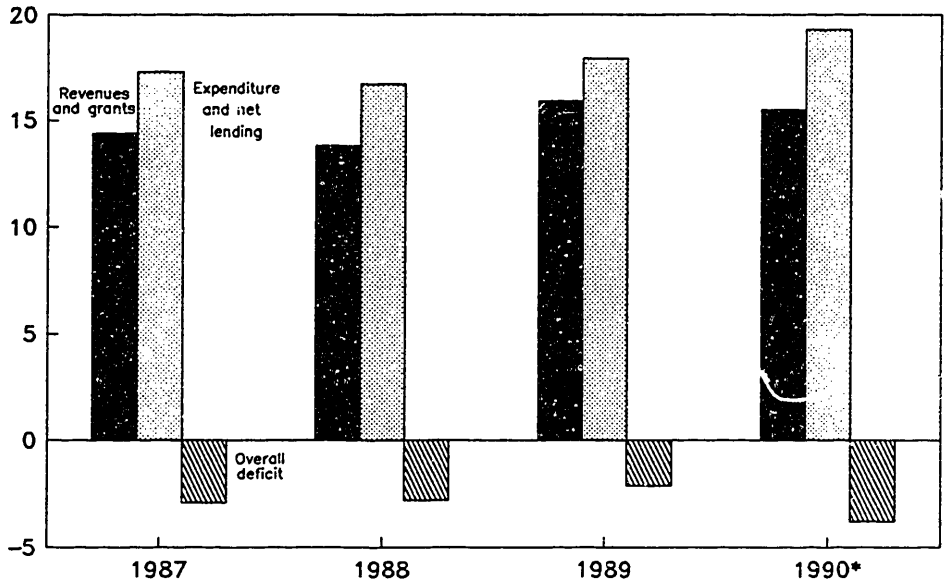
reflecting stronger domestic and foreign demand. Estimated growth for the manufacturing sector in 1990, however, was around 1½ per cent. Primary energy consumption rose by about 9 per cent in 1988 and by some 10 per cent in 1989, with an increase in the share of imported sources (largely oil) in total energy consumption. Imported oil accounts for about 64 per cent of the Philippines' energy needs.

Public finances

20. The consolidated public sector balance of the Philippines comprises the net operating positions of the National Government, 14 non-financial public corporations, the Government Service Insurance System, the Social Security System, local government units, four major government financial institutions, and the net income of the Central Bank.

21. In the period 1986-89, the National Government deficit fell from 5 to 2 per cent of GNP, thanks mainly to rising revenues from domestic taxes, import duties and other grants, which together rose from 13 to 16 per cent of GNP. During the same period, the consolidated public sector deficit, which fell to 2.6 per cent of GNP in 1987, increased again to over 4 per cent in 1989. The main contributors to this deterioration were higher operating deficits by the Central Bank and, in 1989, a large deficit by the Oil Price Stabilization Fund (OPSF), which provides funding for the subsidization of domestic oil consumption.

Graph 2 – Philippines –
National Government Budget
(Percentage of GNP)



Source: IMF.
*Estimate.

22. In 1990, the National Government deficit is estimated to have risen to 3.6 per cent and the consolidated public sector deficit to 5.2 per cent of GNP. Wage and interest payments continued to rise, funds were transferred

to the OPFS and Central Bank operations showed an increased shortfall.

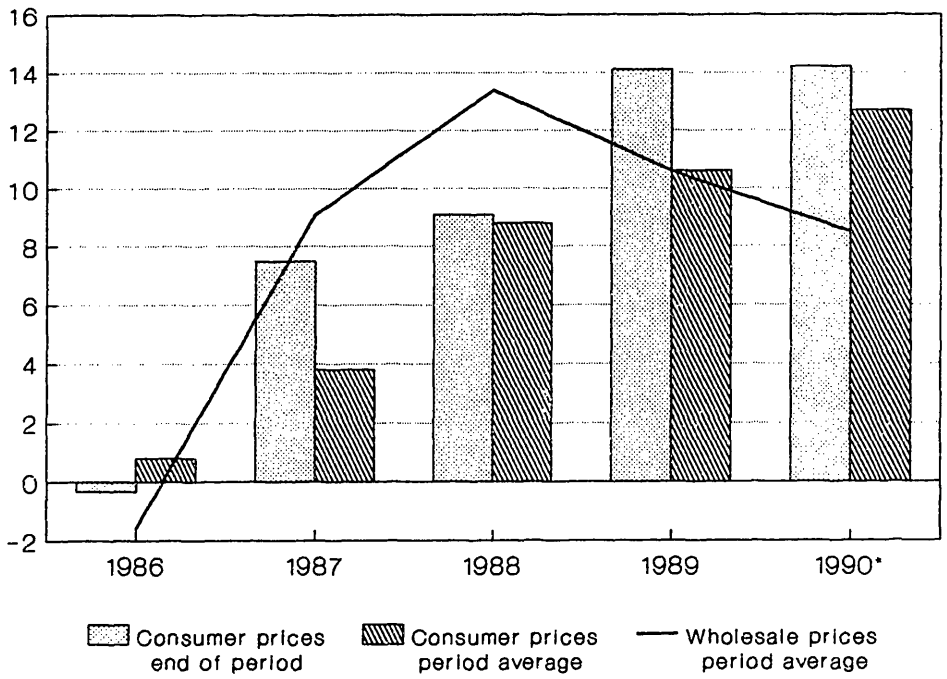
23. The relative shares of domestic and foreign financing in the government deficit have varied considerably over time and show no clear trend. Net foreign borrowing rose from 11½ to 34 per cent of total deficit financing between 1986 and 1987, fell to 18 per cent in 1988, rose sharply to 42 per cent in 1989 and declined to 9.3 per cent in 1990. The non-bank sector is the main source of domestic financing.

Money and credit

24. In 1988, the growth of the monetary base (currency plus deposits of depository institutions in the central bank) increased to 15 per cent (end-year basis) as a result of the rise in the net foreign assets of the central bank and of its continuing net income deficit. As a result of increased confidence in the financial system during the year, the currency-deposit ratio declined and the growth of broad money (M3) doubled to 23 per cent.

25. In the first half of 1989, monetary policy took an expansionary stance following concern over high interest rates. However, monetary policy was tightened in the third quarter of 1989 by a series of measures including an increase in reserve requirements on long-term deposits, an increase in the rediscount rate, larger contractionary open market operations and other measures designed to reduce the liquidity of government agencies. Despite these measures, base money grew by 22 per cent during the 12 months ending September 1989 and by 36 per cent during the 12 months ended December 1989. The result was an acceleration of inflation as measured by consumer prices, which rose (on a period average basis) by 10.6 per cent in 1989, compared with 8.8 per cent in 1988 (Graph 3). At the same time, recorded wholesale price inflation slowed in 1989 to 10.6 per cent from 13.4 per cent the previous year.

Graph 3 - Philippines - Consumer and wholesale prices
(Percentage change)



Source: IMF

* January-August average for wholesale prices for Metro Manila.

26. Over the full year 1990, monetary growth decelerated, with a marked tightening of monetary policy in September. December estimates show annual growth of 23½ per cent in base money and 16½ per cent in M3. Consumer price inflation also slowed in the last quarter; while on a period average basis, the CPI growth increased to 12½ per cent, on an end-of-period basis consumer price increases were not significantly greater than in 1989. Wholesale price inflation continued to fall to an estimated 8.5 per cent for January-August. The effects of the Gulf crisis are likely to have increased wholesale prices after August 1990.

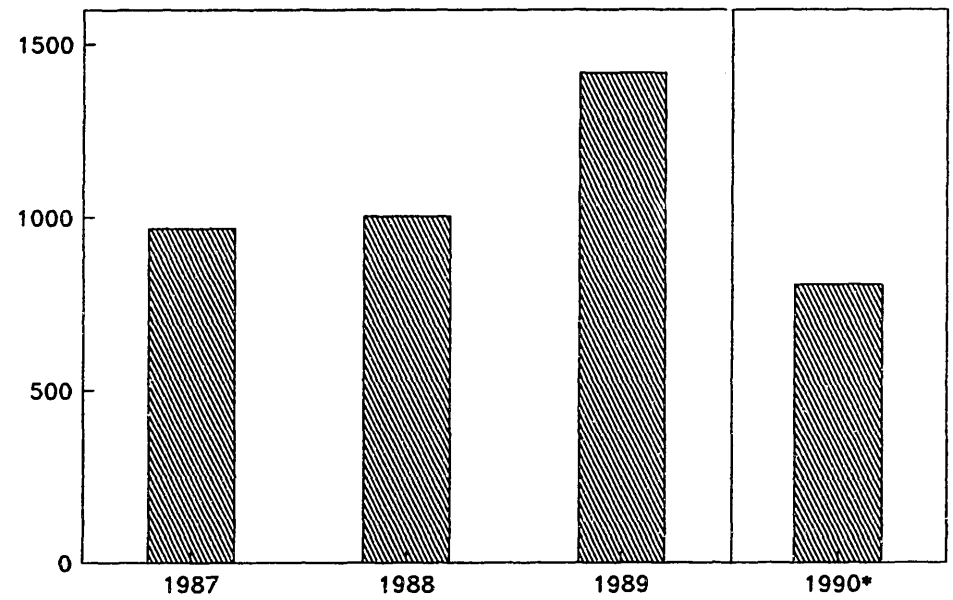
27. During 1988, nominal interest rates rose, partly reflecting a rise in foreign interest rates but also higher domestic inflation and an upward adjustment in inflationary expectations. For the most part, they continued to rise in 1989 and 1990, and have remained positive in real terms.

28. In 1989 and 1990, the Philippines authorities continued the financial sector reform, both of public and commercial banking, which had been initiated in 1986. The aim of the programme in the area of commercial banking is to increase depositor protection, to reduce intermediation costs, to improve supervision of commercial banks and to better the environment for long-term financial intermediation. The development of the capital market is also being pursued and a Bill to strengthen the legal framework for central bank supervision of the banking system has been placed before Parliament.

Balance of payments

29. The Philippines recorded an overall balance of payments surplus of $650 million in 1988, against a surplus of $264 million in 1987 (Table 1). In 1989, despite a current account deficit approaching $1.5 billion (3.3 per cent of GNP), a balance of payments surplus of $451 million was posted. The result was an increase of about one-third in international reserves - to about $1.4 billion, excluding gold - over the course of 1989 (Graph 4). Estimates for January-November 1990 show an overall deficit of some US$350 million.

Graph 4 – Philippines – International reserves (excluding gold)
(Millions US dollars)



*November 1990.
Source: International Financial Statistics, IMF, January 1991

Table 1 - Philippines - Balance of payments
(Millions US dollars)

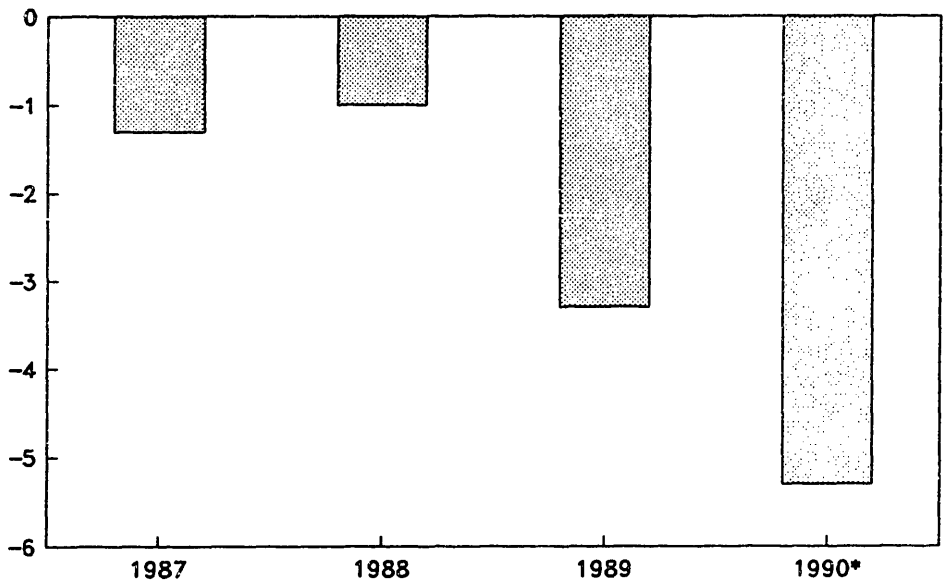
	1987	1988	1989	January-November 1989	January-November 1990
Trade balance	-1 017	-1 085	-2 598	-2 427	- 3 708
- Merchandise exports	5 720	7 074	7 821	7 139	7 420
- Merchandise imports	-6 737	-8 159	-10 419	-9 566	-11 128
Services (net)	0	-113	303	177	630
Transfers (net)	573	775	830	763	647
Current account	-444	-423	-1 465	-1 487	-2 431
Direct investment (net)	326	986	854	755	419
Medium- and long-term loans (net)	159	-486	395	74	119
Short-term capital (net)	-64	176	278	153	559
Monetization of gold and valuation adjustments	287	397	389	342	982
Capital account balance	708	1 073	1 916	1 344	2 079
OVERALL BALANCE	264	650	451	-143	-352

Source: Philippines authorities

Current account

30. The current account deficit of the Philippines fell slightly in 1988 to the equivalent of about 1 per cent of GNP (Graph 5). However, in 1989 it jumped to about 3.3 per cent of GNP. This was a result of the increase in the consolidated public sector deficit and the shift towards an investment-based recovery. The trade gap increased to $2.6 billion as merchandise imports soared, due to strong domestic demand and to the impact of the ongoing import liberalization programme. Despite a 10.4 per cent increase in merchandise exports, the merchandise trade deficit rose to US$2.6 billion in 1989, against US$1.1 billion in 1988, more than offsetting a shift from deficit to surplus in the services account for 1989. Estimates for January-November 1990 show a further increase in the deficit with continuing import growth.

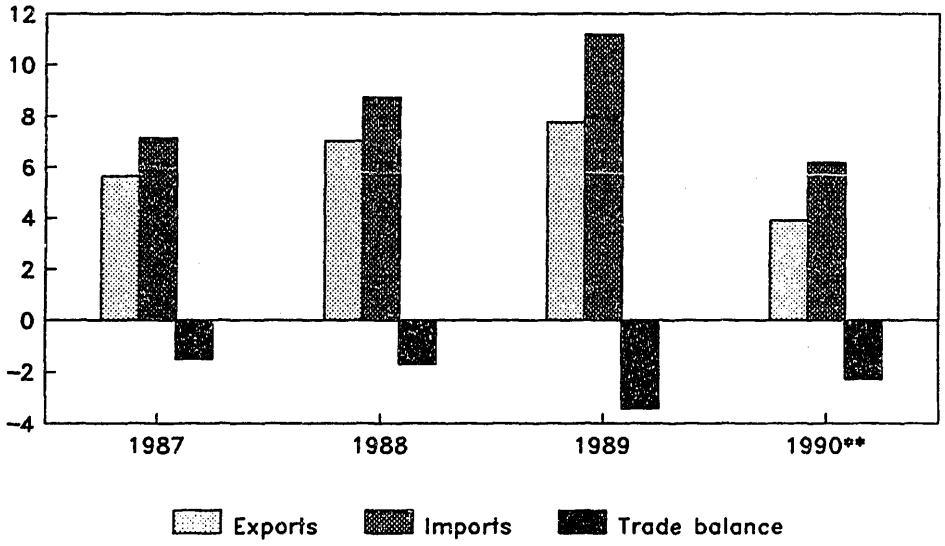
Graph 5 – Philippines – Current account balance
(Percentage of GNP)



*Period January–June.
Source: IMF.

31. In 1988, merchandise exports, valued on a customs basis, were about 24 per cent above their 1987 level both as a result of higher world prices and more rapid growth in volume (Graph 6). Exports continued to grow through 1989, reaching nearly US$8 billion. Merchandise export growth has been concentrated in the nontraditional manufacturing sector, especially electronic products and garments, which are heavily dependent on imported inputs (Table 2). Other manufactured products which achieved sustained growth during the period were furniture, footwear, and processed food. These sectors were favoured by growing world demand, import liberalization measures which increased the availability of imported inputs, and improved domestic political and economic conditions. In contrast, exports of most traditional agricultural products slowed down during 1988 and 1989. For the most part, these trends continued in the first eleven months of 1990.

Graph 6 – Philippines – Value of merchandise trade*
(Billion US dollars)



*Customs basis.
**Accumulated flow through 2nd quarter.
Source: IMF, IFS, January 1991.

Table 2 - Philippines - Composition of exports
(Percentage shares)

			Jan./Nov.	
	1988	1989	1989	1990
Other manufactured goods	22.4	23.7	24.0	23.7
Electronics	20.9	22.2	22.6	24.5
Garments	18.6	19.9	19.4	21.0
Other nonmanufactured goods	8.2	8.5	7.3	7.3
Coconut oil	5.8	4.8	4.8	4.4
Fish, fresh and preserved	4.3	3.8	3.8	3.6
Copper metal	4.2	4.2	4.3	3.5
Copper concentrates	3.0	3.0	3.1	2.5
Lumber	2.2	1.7	1.6	0.3
Bananas	2.1	1.8	1.9	1.8
Gold	1.7	1.4	1.4	1.1
Special transactions and re-exports	1.5	1.0	1.1	1.3
Iron ore	1.2	0.9	1.0	1.0
Desiccated coconut	1.1	0.9	1.0	0.7
Ply wood	1.1	0.4	0.5	0.8
Copra meal/cake	0.9	0.7	0.7	0.7
Sugar	0.8	1.1	1.5	1.8
Total	100.0	100.0	100.0	100.0

Source: Philippines authorities.

32. The economic growth of the Philippines from 1987-89, the program of import liberalization, and increased financing possibilities pushed the growth of the volume of merchandise imports to annual rates in excess of 20 per cent from 1987-89. Imports of capital goods were particularly strong in 1989 (Table 3). The dollar value of oil imports, after dropping in 1988 following the fall in prices, increased last year due to the rise in prices and in volume.[4] Imports of raw materials and intermediate goods grew by 22 per cent (millions of US dollars) in 1989 as a result of strong domestic growth and the need to satisfy the buoyant external demand for electronic products and garments.

Table 3 - Philippines - Composition of imports
(Percentage shares)

			Jan./Nov.	
	1988	1989	1989	1990
Mineral fuels and lubricants	13.5	13.4	13.5	14.7
of which:				
Oil	11.3	10.6	13.1	14.4
Non-fuel imports	86.5	86.6	86.5	85.3
Capital goods	20.0	23.3	23.2	26.0
Raw materials and interm. goods	54.2	51.7	51.8	47.5
Consumer goods	7.3	8.6	8.5	8.8
Special transactions	5.0	3.0	3.0	3.0
Total	100.0	100.0	100.0	100.0

Source: Philippines authorities.

Capital account and international indebtedness

18. Net capital inflows rose sharply in 1988 and again in 1989 (Table 1). Medium-and long-term credits declined in 1988 but recovered in 1989. New foreign direct investment and portfolio investment in the period 1988 were largely related to the operation of the debt-equity swap program for the reduction of the external debt. In the first half of 1989 there was a relative decline in the capital account surplus while recovery of the capital account surplus occurred during 1990.

19. The total external debt of the Philippines declined during 1988 and 1989 as a result of debt-equity conversion and debt-reduction schemes. The stock of external debt (long-and short-term) was about $27½ billion at the end of 1989 and is estimated at $27 billion at end-June 1990. The Philippine authorities have pursued the reduction of the share of

[4]The fuel subsidies programme reduces the sensitivity of oil imports to changes in world prices.

commercial bank debt and sought to rely increasingly upon financing from official multilateral and bilateral sources. Commercial bank debt represented about 44 per cent of total long-term debt at the end of August 1990, a reduction of 9 percentage points relative to December 1987. Rescheduling with Paris Club creditors in 1989 amounted to about $2.3 billion. After taking debt conversions and rescheduling into account, external debt service is estimated by the Philippines authorities to have dropped to 28 per cent of the value of exports of goods and services in 1988 and to about 25 per cent in 1989.

ANNEX

List of Imports Scheduled for Liberalization/Restriction

	ITEMS	No. of Items
I.	For liberalization	
	Animal and meat products	31
	Coffee	9
	Fish and fish products	36
	Sugar	3
	Fertilizers	19
	Potatoes, onions and cabbages	4
	Antibiotics	23
	Consumer goods	33
	Raw materials, spare parts of consumer electrical products	73
	Trucks and buses	10
	Motorcycles	2
	Cars and jeeps	10
	Used tires	2
	Used Clothing	1
	Spare parts for cars, trucks	32
	Diesel engines and parts	10
	Refined petroleum	15
	Coal and derivatives	3
	Brand new trucks and engines	7
	TOTAL	232
II.	For continued restriction	
	Used tires and tubes	6
	Chemicals for explosives	10
	Other chemicals	3
	Colour reproduction schemes	5
	Used vessels and warships	3
	Ammunitions and firearms	24
	Pyrotechnics	2
	Others	2
	Animal and animal effects	40
	Pesticides	7
	Rice and corn	12
	Games and amusements	1
	Gamecocks	1
	TOTAL	116

Source: Central Bank of the Philippines