

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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## Committee on Balance-of-Payments Restrictions

### DRAFT 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\$530 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 Philippine's 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 effective 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 concessionary 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. 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. 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-1950's had now been replaced by 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 since these would help reduce dependence on foreign borrowing and avoid a reduction in the competitiveness of the Philippines' exports.

[Annexes A and B to be appended later]