THE Philippines — an almost open door

A new government and new legislation have redefined the Philippines as a potentially attractive target for foreign investment. However, warns ***Geoffrey Forday****, prospective players must prepare for some complicated red tape. In crafting the rules which will open doors to new industries, the government has ensured that some development avenues will remain shut to all but Filipinos — although there are strong signs that pragmatism will guide future decisions.*

The Supreme Court of the Philippines has declared the Foreign Investments Act (FIA), passed in June 1991, to be constitutionally valid. With this last hurdle cleared, the FIA, together with subsequent Implementing Rules and Regulations (IRR) now has the potential to help convert the Philippines into one of the more liberal countries in Asia for foreign investors.

In a region which has seen dramatic economic growth over the last two decades, the Philippines has lagged appreciably behind its neighbours. Corruption, poor economic management, insurgencies, political instability, feudal economic practices and natural disasters had all combined to reduce the attractiveness of the country for potential foreign investors.

The general elections held in May 1991 brought an end to the-six year reign of the Aquino government. One of the major priorities of the new Ramos administration will be to provide sufficient economic growth to meet the demands of the country's rapidly expanding population and claim a role in the economic rise of the Asian region.

The introduction of the FIA was therefore an important indicator of the previous government's awareness of the need to liberalise the country's investment regulations and promote the Philippines as an attractive country for foreign investors. It is likely that Ramos will continue in this direction; his government has already stated that increased foreign investment will play a fundamental role in stimulating economic growth.

At a recent Austrade seminar on the Philippines, it was pointed out that Australia was the ninth largest exporter to the Philippines. In the categories of simply transformed manufactures (STM) and elaborately transformed manufactures (ETM), the Philippines ranked ninth and twelfth in importance. In total manufactured products, the country was 14th and was more important than China, Iran, France, Italy, Belgium and India. In 1992, Australian exports in total to the Philippines amounted to $515 million. However, despite these figures, Australia still had only 3 per cent of the Philippines import material market in 1991.

Despite the negative image of the Philippines for foreign investors, Australian companies such as CRA — with its $US350 million gold and copper joint-venture project in Benguet Province — have made substantial investments in the country. For these companies, an understanding of the opportunities and restrictions created by

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the FIA will be important in defining their future position in the Philippines.

Economic background

The Philippines owes many of its present difficulties to its past failure to reform its economic system, lagging behind while its Asia-Pacific neighbours were establishing the foundations for their later rapid economic growth. Plans for large-scale infrastructure and manufacturing development which the Marcos regime had sought to implement in the late 1970s were derailed by the 1979 energy crisis and the resulting global recession.

Government spending went out of control as the nation became more and more reliant on foreign loans to fund its economic projects. Vital domestic industries came close to collapse and the government sought to rescue the ailing enterprises by using foreign borrowings to provide equity funding. In effect, it converted what was corporate debt into government equity.

The state was now an active participant in a diverse range of business activities including steel production, banking, oil refining and hotel operations. A Hongkong and Shanghai Bank business profile of the Philippines in 1984 pointed out that some of these state-operated or owned enterprises may have grown rapidly with the government loans, but they also turned out to be highly inefficient in their operations and this necessitated further injections of government funds.

Following the "people power revolution" which installed her as president, Corazon Aquino and her government were faced, economically, with a battle of containment and had limited success in implementing reform. The inability to achieve substantial agrarian reform in what is primarily a rural economy became one of the major failings of the Aquino government.

Nationalism and foreign investment

Until recently, the foundation of the Philippines attitude to foreign investment could be found in the country's constitution, which declares in Article II (1) Section 19: "The State shall develop a self-reliant and independent national economy effectively controlled by Filipinos."

Although the constitution goes on to recognise the importance of encouraging incentives for economic investment, a nationalistic attitude is undoubtedly evident in Section 19. This has been borne out in the role played by the government in actively involving itself in the private sector and in its determination to ensure that certain enterprises remain in Filipino hands. This contrasts with its position on defence-related issues; for example, its willingness to host the American military bases at Subic and Clark, which had been major contributors to the domestic economy.

The Aquino government — somewhat belatedly, according to some commentators — undertook to push through a number of economic reforms in the last eighteen months of its administration. It can be argued that none has been of greater importance than the introduction of the FIA.

The FIA represents a significant change in philosophy away from the narrow economic nationalism of the past to a more liberal and welcoming attitude to foreign investment. In examining the success of its South-East Asian neighbours and the models they provided, economic policy planners realised that attracting and retaining a high level of foreign investment was vital to the growth of a developing economy.

Application of the FIA

The FIA is intended to cover the following companies and enterprises:

- New foreign-owned enterprises and foreign nationals which, while not applying for government incentives, intend establishing a business operation in the Philippines;
- Existing foreign-owned enterprises seeking to increase their foreign equity participation;
- Existing Philippine-owned enterprises seeking to increase or obtain a foreign equity participation greater than 40 per cent.

Section 3(a) of the FIA provides that a "Philippine national" includes a corporation in which at least 60 per cent of the share capital is owned and held by Philippine citizens or by a trust in which at least 60 per cent of the trust fund will accrue to the benefit of Philippine nationals.

Companies listed with the Securities and Exchange Commission (SEC) must also satisfy the condition that not only must 60 per cent or more of the issued capital be held and owned by Philippine citizens but that these shares must have voting rights. The board of directors will also be required to meet the 60 per cent Philippine-citizen threshold test. By referring to the voting rights attaching to shares, the act has provided a control test to be used in determining the true corporate nationality of an enterprise.

Although not expressly defined in the FIA, a company which has 41 per cent or more foreign equity participation would therefore be considered as a "non-Philippine national." It is these companies that the FIA seeks to cover.

The former foreign investment laws required that any enterprise which sought to increase its foreign equity above 40 per cent first needed to obtain the consent of the Philippine Board of Investments (BOI). The BOI's role was not so much to encouraging investment as to determine whether the proposed business activity would provide any benefit to the Philippine economy.

The FIA has, to a large degree, freed up this regulatory requirement by providing a wide enabling clause as a starting position before narrowing the range of investments to designated industries and categories. Clause 5 of the Act provides that BOI consent is not required by such an enterprise provided the enterprise does not rely on government incentives. The only regulatory procedure to be complied with is registration with the SEC or the Bureau of Trade Regulation and Consumer Protection or the Department of Trade and Industry, depending on the business structure of the enterprise.

Companies wishing to rely on the incentives provided under the Omnibus Investment Code of 1987, which apply, for example, to companies establishing regional headquarters or regional warehouses, must register with the BOI which will consider the applications in accordance with criteria set down in the Code.

Table 1: The Philippines in Asia — poised for growth

	Real GDP growth (%)			Inflation (%)		
	1992(e)	*1993(f)*	*1994(f)*	*1992(e)*	*1993(f)*	*1994(f)*
China	9.0	6.0	10.0	8.0	6.5	8.0
Hong Kong	5.0	5.0	6.5	9.0	9.0	10.0
India	4.0	4.5	5.5	12.0	9.5	11.0
Malaysia	8.0	5.0	7.0	5.0	3.5	4.0
Philippines	**2.0**	**2.0**	**4.0**	**8.0**	**7.0**	**8.5**
Singapore	5.0	5.2	5.5	2.3	2.3	2.5
South Korea	6.5	6.0	7.0	6.0	6.0	7.5
Taiwan	6.0	6.0	7.0	4.5	4.0	4.4
Thailand	6.5	7.0	7.5	4.5	5.0	5.5

"Doing business"

The BOI's definition of a "business activity" in the Philippines is very broad. It includes: "Participating in the management or control of a local business, entity or corporation; and any other activities that imply a continuity of commercial dealings. This includes soliciting orders, service contracts, opening offices, including liaison offices or branches and appointing representatives or distributors residing in the Philippines for at least 180 days a year."

It should be noted, however, that the definition of "doing business" does not extend to the "mere investment as a shareholder by a foreign entity in domestic corporations," nor (and importantly) "a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account."

In the latter case, it would not be necessary for a foreign corporation which only deals with an independent representative or distributor for the purpose of distributing its goods in the Philippines to obtain a licence to do business.

The subsequent IRR added to the activities which do not fall within the "business" definition by excluding the following:

- publishing a general advertisement in any print or electronic media;
- maintaining goods in the country solely for processing by another entity in the Philippines;
- consigning equipment by a foreign entity to a domestic company to process products for export;
- gathering information on the Philippines;
- performing services auxiliary to an existing single contract of sale which will not represent a continuing business.

The Negative List

The FIA has specified areas which will not be open to non-Philippine companies, or which are available only after complying with certain criteria. This Foreign Investments Negative List is defined as the "list of areas of economic activity whose foreign ownership is limited to a maximum of 40 per cent of the equity capital of the enterprises engaged therein". In effect, only Philippine nationals will be permitted to invest in Negative List activities.

As mentioned above, the act begins with the view that all foreign investment will be permitted. It then makes this broad policy subject to certain restrictions. In its Declaration of Policy the FIA states that as a general rule there are no restrictions on the extent of foreign ownership of export enterprises. "In domestic market enterprises, foreigners can invest up to 100 per cent equity except in areas included in the Negative List."

The FIA, in fact, refers to two Negative Lists: the Transitory Foreign Investment Negative List (FINL), which applies for three years from 12 November 1991; and the Regular Negative List which will come into effect at the end of that period. Both Negative Lists are in turn divided into three sub-lists which establish the categories of restricted investment.

List A

This list sets out the areas of economic activity reserved for Philippine nationals, including the exploitation of the country's natural resources, public utilities, educational institutions, mass media, rural banking, labour recruitment and retail trade.

List B

This lists activities and enterprises that are "regulated pursuant to law", including:

- defence-related activities such as the manufacture and distribution of firearms and explosives and related materials;
- activities which have implications for "public health and morals" including the production and distribution of dangerous drugs, all forms of gambling, nightclubs, massage parlours and similar activities.

List B also includes small and medium-size "domestic market enterprises" with paid-up equity capital of less than $US500,000 (although an exception exists for companies classified in the category of advanced technology. A "domestic market enterprise" is defined by the FIA as one which does not on a regular basis export 60 per cent or more of its output.

"Export enterprises" which use raw materials from "depleting resources" and have a paid-up equity capital of less than $US500,000 are also included in this list.

The act defines an "export enterprise" as one which exports 60 per cent or more of its output. The IRR further defines "depleting resources" as being "all mineral resources and forest, marine and other renewable resources whose rate of exploitation is faster than its renewal, leading to rapid reduction in the desired level of its capital stock and to the unsustainable supply of products derivable from them".

List C

This list is somewhat arbitrary in that it includes areas of investment in which existing enterprises already adequately serve the needs of the domestic economy and the Philippine consumer and for that reason do not require new or further foreign investment.

These include import and wholesale activities which are not integrated with the production or manufacture of goods, and services which require a licence or official authorisation and which are restricted to Philippine nationals, for example, insurance firms and travel agencies.

The list would also include enterprises which are majority-owned by a foreign licensor and/or affiliates for the production or manufacture of goods for the domestic market. These goods must be produced or manufactured under a technology, know-how or brand-name licence agreement. The pharmaceutical industry is an example.

The Regular Negative List

When the Transitory Negative List is replaced on 11 November 1994 by the Regular Negative List, any company seeking to bring its business activity within the category reserved for Philippine nationals must file a petition setting out reasons why that activity should be included.

The intention of the transitory period is not only to allow Philippine companies to prepare for the entry of foreign competitors but also to allow the government the opportunity to analyse the effect of structural changes to its foreign investment policy.

The FAI will not be applied retrospectively. Foreign-owned companies which have been registered with the BOI under the former investment laws and been granted Certificates of Authority to conduct business will be allowed to continue under the same conditions as they have in the past.

Companies whose activities do not fall within any of the Negative Lists may elect to come within the control of the FIA. A company "opting in" will be automatically registered with the SEC once it surrenders its Certificate of Authority.

Companies with more than 40 per cent foreign ownership which have in the past accepted BOI incentives may also elect to fall within the control of the FIA. By doing so, a company will be considered as having waived its rights to its previously held incentives.

Reasons for optimism

While there has not been any dramatic change to the economic performance of the Philippines over the past twelve months, certain noticeable improvements provide cause for some optimism about the future.

The government's commitment to the IMF stabilisation program remains intact and in 1991, as a result of stricter spending control, the fiscal deficit had been reduced substantially to less than 3 per cent of GNP. Controls on spending had also helped to bring down inflation to about 9 per cent. International reserves of foreign currency now stand at $US5 billion, their highest level for more than 10 years. The privatisation program continues, with around $1.6 billion of government assets already sold.

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The end of the American military presence at Subic Bay and Clark has opened up substantial prime industrial investment areas. Singaporean companies are already moving to exploit the extensive docking facilities at Subic Bay. However, infrastructure weaknesses continue to deter potential foreign investors. In particular, the country's unreliable power generation service results in regular electricity interruptions in the capital. At grass-roots level, economic reform will be difficult as long as effective control of the country's economy remains in the hands of a few families. Further, debt servicing accounts for up to 40 per cent of the national budget.

The government has attempted to confront major economic problems with incentives for private-sector participation in infrastructure development through the "Build-Operate-Transfer Law", productivity incentives and research and development incentives, as well as the provisions of the Foreign Investment Act.

The FIA recognises the compelling need for foreign investment in areas of potential national development. An important requirement in achieving its economic potential will be the Ramos administration's ability to respond to the demand for foreign investment while retaining control of economic growth.

To provide a further impetus to foreign investment, additional legislation has been enacted to support the FIA. For example, an act provides for tax credits and exemptions in relation to the import of manufacture of capital equipment.

Even more important has been the liberalisation of foreign exchange transactions, making it substantially easier for foreign investors to repatriate earnings in foreign currency and for Philippines exporters to retain earnings in foreign currency.

It remains to be seen whether the "Negative List" concept will be a workable structure permitting foreigners to invest in areas attractive to them. The economic activities which are prohibited to foreign investors or reserved to Philippine nationals may in fact be the preferred areas of foreign investment. It is likely that these lists will be further refined as a better understanding of the needs of foreign investors develops.

In fact, advisers to Ramos have referred to the possibility of abolishing the FIA's Negative Lists altogether and further freeing up the Philippine market to foreigners. Such developments will be observed with a great deal of interest. ■