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BETTER POLICIES FOR BETTER LIVES

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Foreword

This first OECD Investment Policy Review of the Philippines *uses the OECD* Policy Framework for Investment *to assess the investment climate in the Philippines, including the institutional and legislative framework for investment. It includes chapters on investment regulation and protection, investment promotion and facilitation, competition policy, infrastructure and responsible business conduct.*

The Review *was undertaken in partnership with the ASEAN Secretariat and involved three Task Forces within the Philippine government chaired by Department of Trade and Industry Secretary Adrian Cristobal. The Task Forces covered investment policy, investment promotion and facilitation and competition policy.*

This publication is based on a background report that was presented and discussed in the OECD Advisory Group on Investment and Development in Paris in October 2015. The Philippine delegation was led by Secretary Cristobal. A draft version of the Review *was discussed at a workshop gathering government agencies and stakeholders, organised by the Government of the Philippines in Manila in July 2015.*

The Review *has been prepared by a team comprising Stephen Thomsen, Mike Pfister, Hélène François, John Hauert, Carole Biau, Barbara Bijelic and Leona Verdadero, with inputs from Fernando Mistura, Alexandre de Crombrugghe and Rose Poreaux, all from the Investment Division of the OECD Directorate for Financial and Enterprise Affairs, and Hilary Jennings, an external consultant. The* Review *was supported by the ASEAN-Australia-New Zealand Free Trade Agreement Economic Cooperation Support Programme.*

The information in this Review *is current as of end-December 2015.*

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Preface

by

Adrian S. Cristobal Jr., Secretary of the Department of Trade and Industry, Philippines and Angel Gurría, Secretary-General, OECD

The Philippine economy has sustained strong growth despite a general slowdown in the global economy. Fuelling this expansion were remittances, direct foreign investments, a robust business process outsourcing industry and the resurgence of manufacturing. We also attribute this positive outcome to the economic reforms implemented in the past six years. Improving transparency in government, the easing of red tape and regulations, and the creation of industry policies that encourage healthy competition, have also helped establish a sound investment climate in the Philippines.

Our outlook for the coming years remains optimistic even as the Philippines continues to strive to make economic development more inclusive and sustainable. It is in this context that we embarked on the publication of a book that will contribute to promote a stable investment environment in the country.

The first *OECD Investment Policy Review of the Philippines* provides a comprehensive approach to investment climate reform. This book highlights the main points of the recently updated *OECD Policy Framework for Investment* (PFI), focussing in particular on how to strengthen policies and institutions to make investment more attractive, ultimately benefiting society at large.

In conceiving the *Investment Policy Review*, the Philippine government established three cross-government task forces on investment policy, investment promotion and facilitation, and competition policy. This allowed for full ownership and a whole-of-government approach to investment policy-making. The OECD supported these efforts through its policy tools and its vast wealth of knowledge and experience with investment promotions for development. The OECD is currently working bilaterally with the Philippines on several fronts including agricultural policies and the governance of public-private partnerships.

This collaboration with the OECD takes place amid strengthening links between the OECD and the Association of Southeast Asian Nations (ASEAN) Member States. In 2014, the OECD formally launched its Southeast Asia Regional Programme. This broad co-operation covers trade, taxes, regulatory practices, investment policies and promotion, education and skills development, SMEs, and public-private infrastructure ventures. This book builds on the OECD's investment work with the ASEAN, a partnership that allows for an open exchange of information with regional peers.

Thus, we would like to express our gratitude to the ASEAN-Australia-New Zealand Free Trade Area Economic Co-operation Support Programme for the support they gave to the *Review.*

So it is with great pride that we present this invaluable collaboration between the Government of the Philippines and the OECD, a vital and comprehensive report that also serves as the harbinger of deeper co-operation to achieve an even stronger and sustainable Philippine economy.

Adrian S. Cristobal Jr.

Secretary of the Department of Trade and Industry

Government of the Philippines

Angel Gurría

Secretary-General

OECD

Acronyms and abbreviations

ACIA	ASEAN Comprehensive Investment Agreement
ADR	Alternative Dispute Resolution
ADB	Asian Development Bank
AEC	ASEAN Economic Community
AEGC	ASEAN Experts Group on Competition
AFAB	Authority of the Freeport Area of Bataan
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
ATO	Air Transportation Office
AWGIPC	ASEAN Working Group on Intellectual Property Cooperation
BIT	Bilateral Investment Treaty
BOI	Board of Investments
BOI-ARMM	Autonomous Region of Muslim Mindanao
BOP	Balance of Payments
BOT	Build-Operate-Transfer
BOT-IRR	Philippine Amended BOT Law and implementing rules & regulations
BPO	Business Process Outsourcing
BPM6	Balance of Payments Manual 6
BSP	Bangko Sentral ng Pilipinas
BTRCB	Bureau of Trade Regulation and Consumer Protection
CARP	Comprehensive Agrarian Reform Programme
CDC	Clark Development Corporation
CEZA	Cagayan Economic Zone Authority
CHR	Commission on Human Rights
CIQ	Customs, Immigration and Quarantine
CPCN	Certificates of Public Convenience and Necessity
CQRS	Consolidated Quarterly Reporting System
CSF	Credit Surety Fund
CSR	Corporate Social Responsibility
DBP	Development Bank of the Philippines
DENR	Department of Environment and Natural Resources

DILG	Department of the Interior and Local Government
DITC	Department of Information and Communications Technology
DOE	Department of Energy
DOJ	Department of Justice
DOLE	Department of Labor and Employment
DOTC	Department of Transportation and Communication
DPWH	Department of Public Works and Highways
DTI	Department of Trade and Industry
EITI	Extractive Industries Transparency Initiative
EIU	Economist Intelligence Unit
EO	Executive Order
EPA	Economic Partnership Agreement
EPIRA	Electric Power Industry Reform Act
EPZ	Export Processing Zone
ERC	Electricity Regulatory Commission
ERIA	Economic Research Institute for ASEAN and East Asia
EU	European Union
EUR	Euro
FAO	United Nations Food and Agriculture Organisation
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FIA	Foreign Investment Act
FIL	Foreign Investment Law
FINL	Foreign Investment Negative List
FIIS	Foreign Investments Information System
FPIC	Free Prior and Informed Consent
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GOCCs	Government-Owned and Controlled Corporations
GPFI	Global Partnership for Financial Inclusion
GPRA	Government Procurement Reform Act
GRI	Global Reporting Initiative
GVC	Global Value Chain
IAG	Inter-Agency Group
IAG-FDIS	Inter-Agency Group on Foreign Direct Investment Statistics
ICT	Information and Communication Technology
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
ILO	International Labour Organization

IMF	International Monetary Fund
IP	Intellectual Property
IPA	Investment Promotion Agency
IPOPHL	Intellectual Property Office of the Philippines
IPP	Independent Power Producer
IPP	Investment Priorities Plan
ISDS	Investor-State Dispute Settlement
ISO	International Organization for Standardization
IT	Information Technology
JICA	Japan International Cooperation Agency
KPI	Key Performance Indicators
LAC	Latin America and the Caribbean
LGU	Local Government Unit
LWUA	Local Water Utilities Administration
M&A	Mergers and Acquisitions
MFN	Most-Favoured Nation Treatment
MNE	Multinational Enterprise
MOA	Memorandum of Agreement
MORB	Manual of Regulations for Banks
MSME	Small and Medium-Sized Enterprises
MWSS	Metropolitan Waterworks and Sewerage Systems
NAFTA	North American Free Trade Agreement
NAP	National Action Plan
NEDA	National Economic and Development Authority
NEDA-ICC	NEDA's Investment Co-ordination Committee
NPC	National Power Corporation
NRPS	National Retail Payment System
NSCB	National Statistics Coordination Board
NSFI	National Strategy for Financial Inclusion
NSO	National Statistics Office
NT	National Treatment
NTC	National Telecommunication Commission
NWRB	National Water Resources Board
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OFC	Office for Competition
OIC	Omnibus Investment Code
OSW	Ocean, Solar and Wind
PBSP	Philippine Business for Social Progress
PDMF	Project Development and Monitoring Facility
PDP	Philippines Development Plan

PEZA	Philippines Economic Zone Authority
PFI	Policy Framework for Investment
PHP	Philippine pesos
PIPP	Philippine Investment Promotion Plan
PLDT	Philippines Long Distance Telephone Company
PMIA	Philippine Model Investment Agreement
PNP	Philippine National Police
PPA	Philippine Port Authority
PPP	Public-Private Partnership
PSIC	Philippine Standard Industrial Classification
RA	Republic Act
RBC	Responsible Business Conduct
RCOA	Retail Competition and Open Access
RO-RO	Roll-On / Roll-Off
SBMA	Subic Bay Metropolitan Authority
SCAD	Subic Clark Alliance for Development
SEC	Securities and Exchange Commission
SEZ	Special Economic Zones
SME	Small and Medium-Sized Enterprises
SRC	Sector Regulators Council
SRP	Suggested Retail Price
TiVA	Trade in Value Added
TVET	Technical Vocational Education and Training
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Commission on Trade and Development
UNESCAP	UN Economic and Social Commission for Asia and the Pacific
UNGC	UN Global Compact
UNGPs	UN Guiding Principles for Business and Human Rights
USD	United States Dollar
VAT	Value Added Tax
WB	World Bank
WTO	World Trade Organization

Executive summary

The Philippine economy is currently one of the fastest growing in the region. Both remittances and foreign direct investment (FDI) are at record levels, the business process outsourcing sector is booming, the country is improving in international rankings and has been upgraded by credit rating agencies. Beyond macroeconomic and political stability, these economic improvements are in part the cumulative result of reforms since the late 1980s, notably trade liberalisation, deregulation, privatisation and the breaking up of long-standing monopolies in some key sectors during the 1990s under President Ramos. More recently, the Aquino administration has made efforts to increase transparency, improve public-private dialogue and address corruption, together with liberalisation in the financial and maritime transport sectors and the enactment of the new Competition Act which should create new market opportunities for both domestic and foreign investors. These important reforms should help to sustain the improved performance of the Philippine economy.

Long decried for its unfulfilled potential, the Philippines has finally achieved some measure of success. Reforms in some key sectors such as telecoms have paid off handsomely and have helped to spur a new industry: business process outsourcing. The Philippines has improved in some international competitiveness rankings and has strengthened its investment promotion and facilitation strategy. The framework for private participation in infrastructure has improved and investors in general enjoy strong protection under domestic law and, where applicable, through treaties.

These earlier and on-going reforms have had an impact on the performance of the Philippines, including the strong growth since 2010. But in spite of this commendable success, a strong case can be made that the process is not complete and that further steps might help to achieve the critical mass of reforms required to place the Philippines on a sustained and more inclusive growth trajectory.

Restrictions on FDI in the Philippines are high by both regional and global standards. Foreign equity restrictions exist in many non-manufacturing sectors, minimum capital requirements are high and land ownership is prohibited for foreigners. Many restrictions are enshrined directly in the Constitution, rather than in an investment law or sectoral legislation, with the result that reforms have proved very difficult to enact. A separate regime exists for export-oriented investors but, with little scope to participate in the local economy, these investments have provided few linkages.

Reforming the Constitution, or charter change, has been discussed for almost as long as the 1987 Constitution has been in existence, and calls for change are widespread – from within government, the media, local and foreign chambers of commerce, not to mention internationally from partner countries and international organisations. This first *OECD Investment Policy Review of the Philippines* adds its voice to this chorus, but if the refrain is familiar, the approach to the question is comprehensive and brings in insights from peers in Southeast Asia and elsewhere and includes proposals for reforms which do not depend on the Constitution. The Review argues that, taken together, FDI liberalisation and the new Competition Act can provide more of an impulse to new market entry and greater competition than either could achieve alone. With no large cohort of medium-sized local firms available to enter new markets, the most credible threat to incumbents might come from foreign investors.

The persistent problem of under-investment in the Philippines is not limited to attracting FDI, since domestic investment is still low in spite of a booming economy. Policy reform should not aim to give foreign investors special treatment, but a strong argument can be made that removing barriers to FDI in the Philippines could help to address issues of under-investment by domestic firms through the impact that FDI might have on improving the overall investment climate itself, not least through improved access to finance and infrastructure, and good practices in business integrity, corporate governance and responsible business conduct.

The Philippines has a huge potential to attract FDI but has been hampered in its efforts by the legacy of nationalist policies from the 1980s. In a more conducive policy environment, the Philippines offers tremendous advantages to potential investors: its location in the world's most dynamic region, a large and fast-growing market, knowledge of English, abundant natural resources, a young population and political stability. Where reforms have occurred, foreign investors have responded enthusiastically. The challenge is not only to attract foreign investors but also to persuade domestic firms to invest and above all to ensure that the investment that arises helps contribute to inclusive and sustainable development. Reforms in the Philippines all move in the right direction but the reform agenda is not complete. This Review describes major reform episodes and their impact and explores the options for further reforms, not only concerning FDI restrictions but in other areas as well.

Assessment and recommendations

Introduction

The Philippine economy has been transformed over the past decade into one of the fastest growing in the region, currently outperforming other major ASEAN economies. Growth has been spurred by record remittances from overseas Filipinos which has helped to fuel domestic consumption, as well as by the booming business process outsourcing (BPO) sector. Macroeconomic stability has been accompanied by sound fiscal management and political stability with a stable democracy and regular elections. The Philippine economy received a further vote of confidence in 2013 when credit rating agencies upgraded it to a BBB investment grade status. It has also improved its performance in several international rankings. Inflows of foreign direct investment (FDI) are also at record levels, albeit still low by regional standards.

These economic improvements are in part the cumulative result of reforms since the late 1980s, notably deregulation, privatisation and the breaking up of long-standing monopolies during the 1990s under President Ramos. These reforms encompassed the air transport, telecommunications, banking, oil and water sectors, among others. As a legacy of these reforms, state ownership is less of an obstacle to private investment than in some other countries in the region.

More recently, the Aquino administration has made efforts to increase transparency and address corruption, together with further liberalisation in the financial and maritime transport sectors and the enactment of the new *Competition Act*. These important reforms will help to sustain the improved performance of the Philippine economy in the years to come. In spite of considerable uncertainty at present in the global economy, the prospects for the Philippines have almost never been better. Completing the reform process and consolidating existing reforms will help to ensure that the Philippines takes full advantage of its location within the world's most dynamic region and particularly as part of the ASEAN Economic Community.

This recent performance stands in sharp contrast to the record of much of Philippine post-independence development, not least the lost decade of the 1980s, but many challenges nevertheless still remain. These challenges were outlined in the Philippine Development Plan (2011-16) and include pervasive corruption and the need to make growth both inclusive and sustainable. In spite of improvements over time in its performance based on the World Bank's *Doing Business* indicators, the Philippines remains a difficult place to do business – as attested by investor surveys. This regulatory burden explains in part the poor performance of the Philippines both in attracting foreign investment and also in raising the level of domestic investment which is low both historically and compared to neighbouring countries.

Furthermore, regional competitors for foreign investment are not standing still but are continuing with their own reforms. Viet Nam has revised its investment law many times over the past two decades, most recently in 2014, and Cambodia and Lao PDR are also currently doing so. Myanmar has re-opened to foreign investment and is also reforming rapidly. Some regional players are also participating in international agreements, such as the Trans-Pacific Partnership, which will spur further reforms in these economies in return for improved market access in major export markets.

All of this cautions against too great a sense of complacency in the Philippines. The government deserves praise for the fight against corruption and new legislative endeavours, not least the new *Competition Act*, but many challenges remain. As stated in the Philippine Development Plan, "economic and political opportunities now exist for a real change…" and this is as true today as it was when the Plan was first drafted. Although reforms are often associated with crises, it would clearly be preferable to undertake them at a time of rapid economic growth. This Review looks at many areas of potential and actual reform: investment policies and promotion, competition and infrastructure.

The persistent problem of under-investment in the Philippines is not limited to attracting FDI, since domestic investment is still below what it was in the 1990s as a share of GDP in spite of a booming economy. Policy reform should not aim to give foreign investors special treatment, but a strong argument can be made that removing barriers to foreign investment in the Philippines could help to address issues of under-investment by domestic firms through the impact that foreign investors might have on improving the overall investment climate itself. These potential benefits result in productivity improvements: in the acquired firm itself through the transfer of technology and intangible assets; in the sector through greater competition and downstream in all sectors which rely on the first sector for inputs. While these benefits are vital for long-term improvements in living standards, investment is not an end in itself, be it foreign or domestic investment. Foreign investors are typically assumed to bring capital, technology and access to global markets, but they can also contribute in other areas as seen below:

- *Competition*: foreign investors bring new competition to oligopolistic markets sometimes characterised by collusion and price fixing. The new *Competition Act* is designed to address the relatively high firm concentration in many sectors in the Philippines, but with the dearth of medium-sized firms able to enter new markets and compete with the larger incumbents, new entrants are often more likely to be foreign.

- *Finance and infrastructure*: these sectors are both destinations for investment and also inputs for all other sectors in the economy. Foreign investment has, in many cases, been associated with improvements in both the price and quality of infrastructure and banking services which benefits virtually all firms in the economy. Many other services are also inputs for a wide range of firms in other sectors, such as professional services, and to the extent that FDI raises performance in these sectors, it will benefit the competitiveness of all sectors downstream.

- *Good practices*: many multinational investors face increasing home country scrutiny in the area of corruption and face strong reputational risks from social or environmental practices which do not meet international standards. They often bring with them good practices in corporate governance, responsible business conduct and other areas.

The question of how investment can contribute to more inclusive and sustainable development is at the core of the *Policy Framework for Investment* (PFI) which underpins this *Review* (Box 1). The PFI recognises that a good investment climate is not just one which raises corporate profitability but also one which raises the social return from investment. The poor in the Philippines are generally those that suffer the most from high prices of basic commodities such as food as well as transport.

Box 1. **The Policy Framework for Investment**

The *Policy Framework for Investment* (PFI) helps governments to mobilise private investment in support of sustainable development, thus contributing to the prosperity of countries and their citizens and to the fight against poverty. It offers a list of key questions to be examined by any government seeking to create a favourable investment climate. The PFI was first developed in 2006 by representatives of 60 OECD and non-OECD governments in association with business, labour, civil society and other international organisations and endorsed by OECD ministers. Designed by governments to support international investment policy dialogue, co-operation, and reform, it has been extensively used by over 25 countries as well as regional bodies to assess and reform the investment climate. The PFI was updated in 2015 to take this experience and changes in the global economic landscape into account.

The PFI is a flexible instrument that allows countries to evaluate their progress and to identify priorities for action in 12 policy areas: investment policy; investment promotion and facilitation; trade; competition; tax; corporate governance; promoting responsible business conduct; human resource development; infrastructure; financing investment; public governance; and investment in support of green growth. Three principles apply throughout the PFI: policy coherence, transparency in policy formulation and implementation, and regular evaluation of the impact of existing and proposed policies.

The value added of the PFI is in bringing together the different policy strands and stressing the overarching issue of governance. The aim is not to break new ground in individual policy areas but to tie them together to ensure policy coherence. It does not provide ready-made reform agendas but rather helps to improve the effectiveness of any reforms that are ultimately undertaken. By encouraging a structured process for formulating and implementing policies at all levels of government, the PFI can be used in various ways and for various purposes by different constituencies, including for self-evaluation and reform design by governments and for peer reviews in regional or multilateral discussions.

The PFI looks at the investment climate from a broad perspective. It is not just about increasing investment but about maximising the economic and social returns. Quality matters as much as the quantity as far as investment in concerned. It also recognises that a good investment climate should be good for all firms – foreign and domestic, large and small. The objective of a good investment climate is also to improve the flexibility of the economy to respond to new opportunities as they arise – allowing productive firms to expand and uncompetitive ones (including state-owned enterprises) to close. The government needs to be nimble: responsive to the needs of firms and other stakeholders through systematic public consultation and able to change course quickly when a given policy fails to meet its objectives. It should also create a champion for reform within the government itself. Most importantly, it needs to ensure that the investment climate supports sustainable and inclusive development.

The PFI was created in response to this complexity, fostering a flexible, whole-of-government approach which recognises that investment climate improvements require not just policy reform but also changes in the way governments go about their business.

For more information on the *Policy Framework for Investment*, see: www.oecd.org/investment/pfi.htm.

The Philippine economy appears at last to have achieved the basis for more sustained growth, and recent policy reforms are likely to provide a further push. Long decried for its unfulfilled potential, the Philippines has finally achieved some measure of success. Reforms in some key sectors such as telecoms have paid off handsomely and have helped to spur a new industry: business process outsourcing. While this performance might create a sense of complacency, there is a strong case to be made that the reform process is not complete and that further steps might help to achieve the critical mass of reforms required to place the Philippines on a sustained and more inclusive growth trajectory.

The Philippines has a huge potential to attract foreign direct investment but has been hampered in its efforts by the legacy of nationalist policies from the 1980s and earlier. In a more conducive policy environment, the Philippines offers tremendous advantages to potential investors which are well-known: its location in East Asia which is the world's most dynamic region, a large and fast-growing market, knowledge of English, abundant natural resources, a young population and political stability. Where reforms have occurred, foreign investors have responded enthusiastically. The challenge is not only to attract foreign investors but also to persuade domestic firms to invest and above all to ensure that the investment that arises helps contribute to inclusive and sustainable development. This Review describes major reform episodes and their impact and explores the options for further reforms in the area of investment regulation and promotion.

Successful reforms provide a platform to address remaining challenges

The Philippines has improved in some international competitiveness rankings

The *Global Competitiveness Index* ranks the Philippines 47th out of 144 economies, up from 52nd in 2014 and 59th in 2013. The Philippines has done particularly well in fighting corruption according to this Index since 2010, when the Aquino administration took office. Overall, the country has gained 38 places in the WEF rankings since 2010 – the largest over the period among all countries studied, but it still ranks poorly in terms of the degree of market competition. The Philippines has also significantly improved its ranking in the Heritage Foundation *Economic Freedom Index*. In terms of the World Bank's *Doing Business* indicators, the Philippines has continued to improve its performance in absolute terms (in terms of distance to frontier), although its ranking slipped most recently to 103rd place, down from 97th the year before. The Philippines ranks particularly poorly in starting a business, getting credit and protecting minority investors.

…and is strengthening its investment promotion and facilitation strategy

The authorities recognise these business climate challenges, and the Philippines Development Plan (PDP) 2011-16 identifies 'improved governance' as a priority reform area. This includes streamlining bureaucratic procedures and fostering transparency; and promoting a consistent, coherent, cohesive, predictable, and responsible policy environment. Investment promotion agencies in the Philippines have also endeavoured to offer one-stop-services to investors, and some agencies such as the Philippine Export Zone Authority are recognised internationally for the quality of their investment facilitation. This service is currently only provided to firms within export-processing zones, and it has proven difficult to generalise it. One impediment to an improved business climate is at the local level, where local government units have often failed to provide a streamlined business registration service and sometimes confront investors with an inconsistent regulatory environment.

Beyond investment facilitation, the government has gone a long way to improve the effectiveness and focus of investment promotion, in part by aligning the Investment Priorities Plan (IPP) with the PDP through a thorough consultative process. The 2014 IPP underwent an extensive "peer review" of a group of the country's leading economists; numerous inter-agency consultations; several sector or cluster focused consultations; and, four regional consultations. It has resulted in a better channelling of private sector perceptions in policy elaborations and ultimately a more robust overall investment promotion and industrial development strategy. Efforts are also underway to improve coordination among the 17 investment promotion agencies and to build capacity in local government units which have been the weakest link in the chain of investment promotion and facilitation. Ultimately, the many investment promotion agencies will need to move beyond promotion for its own sake to provide greater development impact from investment by fostering linkages with local firms, including SMEs.

The Competition Act is a landmark achievement

The adoption of the new *Competition Act* in July 2015 marks the end of over 20 years of legislative discussion over the law and signals the country's readiness to tackle the anti-competitive practices and regulatory barriers that dominate the business landscape. The Philippines now meets its ASEAN commitment to have a comprehensive competition law in place by the end of 2015. The competition law is expected to stand the country in better stead to attract inward investment, promote sustainable and inclusive growth, and facilitate access to global markets in future trade negotiations.

The Act aims to prevent business entities from entering into anti-competitive agreements such as fixing, controlling or maintaining prices; setting, limiting or controlling production; market sharing; and bid rigging. A Competition Commission will oversee all matters related to promotion of competition throughout the economy by investigating and punishing anti-competitive practices, promoting awareness and compliance as well as analysing the practice of competition in markets that affect the Philippine economy. Despite the presence of a number of sector-specific competition laws, as well as institutional arrangements to regulate natural monopolies, they have not in the past consistently dealt with the wide range of anti-competitive behaviour that has emerged or could emerge.

The Philippines' long history of protectionism fostered the proliferation of oligopolies which limited competition and discouraged investment. Many industries are controlled by a few firms. In manufacturing, the average four-firm concentration ratio (the proportion of an industry's output accounted for by the 4 largest firms) across all subsectors rose from 71% in 1988 to 81% in 1998. Most subsectors with a high concentration ratio involve the production of intermediate and capital goods.[1] This oligopolistic tendency resulted in high price-cost margins in the manufacturing sector and undermined its international competitiveness.

Prior to the liberalisation measures in the 1990s, the utility, transport, communication, and agribusiness industries operated with minimal competition. These sectors, owned by a few politically-connected corporate conglomerates that enjoyed high barriers to entry, provided inputs and vital logistics support to manufacturing. For instance, competition in port services is weak and the Philippines Ports Authority serves as both the regulator and a major operator. Competition in domestic shipping is limited, which contributes to large-scale inefficiencies and higher prices of many goods, especially food.[2] Lack of competition in the shipping industry, together with poor ports services, contributes to high logistics costs.

The framework for private participation in infrastructure has improved

Infrastructure deficits have consistently been cited by investors as one of the most problematic factors for doing business. Firms face frequent power outages and a geographically concentrated power supply, slow and expensive internet connections and a transport sector of low quality relative to other ASEAN countries. Levels of public spending on infrastructure relative to GDP have historically been low and the Philippines has in the past had a poor track record with public-private partnerships (PPPs), characterised by poor risk management, fiscally unsustainable government guarantees provided to private partners and excessive use of unsolicited bids. The sector is also characterised by a multiplicity of laws and regulations relevant to private participation in infrastructure.

The government is taking steps to address these weaknesses, including through increased budgetary allocations, enhanced PPP programmes which are more aligned with international best practice and substantially improved transparency and risk management within its legal framework for infrastructure procurement. A PPP Centre was established and has received high marks in international rankings in terms of PPP readiness. Sectoral reforms include telecommunications where the former monopolist now faces direct competition. Reforms are still pending to give greater independence to sectoral regulators, some of which still operate as developers, operators and regulators.

These reforms all move in the direction of improving the regulatory environment and will encourage private participation in infrastructure. Most private investment in infrastructure is domestic, and, for the moment, the proportion of foreign investments in infrastructure is still lower in the Philippines than in most other ASEAN countries. The relative absence of foreign investors stems partly from the past experience with PPPs and the uncertain and complex regulatory environment but also from the constitutional limit of 40% foreign equity allowed in infrastructure sectors and the restrictions on the access of foreign-owned firms to public procurement. Although solutions have sometimes been found to work around these rules, such as by distinguishing between shares and voting rights or between the owner and operator of a public utility, such restrictions are likely to continue to deter foreign investors for reasons which will be discussed further below.

Investors enjoy strong protections under domestic law and, where applicable, through treaties

Both foreign and domestic investors now benefit from key protection provisions under domestic law. The law contains specific provisions granting fair and prompt compensation in case of expropriation and a right of appeal to challenge administrative decisions. Foreign investors are allowed to hire both domestic and foreign employees and are granted rights of residence and free repatriation of capital. Both domestic and foreign investors are also provided with guarantees of legal stability and predictability of investment incentives, thus preserving policy flexibility to introduce changes to other aspects of the investment regime. Although the current regime is comprehensive, the existence of two separate laws governing investment (the *Omnibus Investment Code* and the *Foreign Investment Act*) might impede its readability.

The legal and institutional framework for protecting investors' intellectual property (IP) rights has been substantially strengthened over the past years, notably with the recent amendment of the IP Code, which has brought IP regulations closer to international best practices. Major modernisation reforms are currently being undertaken to improve the quality of IP investigation and prosecution but it is too soon to measure their impact on the quality of enforcement of IP rights.

FDI restrictions are coming down slowly but still remain a barrier

The Philippine government has liberalised some key sectors since the restoration of democracy, particularly under the Ramos administration in the 1990s and most recently under President Aquino. An amendment to the *Foreign Investment Act* in 1996 abolished the restriction on foreign investment in "adequately served" sectors. Reforms in the banking sector in the 1990s and again in 2014 substantially liberalised the sector for foreign banks. Retail trade was partially opened up in 2000, although certain restrictions remain. These reforms have spurred FDI into these sectors, as investors seize on opportunities to supply the large Philippine market. Those export-oriented investors locating in special economic zones also enjoy a more favourable regime.

At the same time, FDI restrictions in the Philippines are high by both regional and global standards. There is no separate screening of foreign investors, but foreign equity restrictions exist in many non-manufacturing sectors, minimum capital requirements are high and land ownership by foreigners is prohibited. The Foreign Investment Negative List contains a long list of economic activities where foreign equity is either prohibited or limited to a certain percentage. A separate regime exists for export-oriented investors, but with little scope to participate in the local economy, these investments have provided few linkages and are relatively few in number because investment promotion agencies are not able to leverage the large and fast-growing local market to attract investors.

Foreign investors face a minimum capital requirement of USD 200 000 which is among the highest worldwide. Although the threshold is lower for investors bringing technology or employing more than 50 workers, this level can constitute a serious obstacle for small foreign investors, particularly in sectors such as tourism where investments can sometimes be small scale. Although small projects are almost by definition likely to have a small impact, small investors overall can sometimes bring a disproportionate benefit to the local economy.

To benchmark the extent of discrimination against foreign investors across countries, the OECD has developed the *FDI Regulatory*

Restrictiveness Index (*FDI Index*) which now covers roughly 65 countries. The *FDI Index* does not provide a full measure of a country's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the *FDI Index*, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' international investment policies, measuring reforms and explaining variations among countries in attracting FDI.

The Philippines is one of the countries with the most statutory restrictions on foreign investment, according to the *FDI Index*. It has more statutory restrictions than any of the large ASEAN Member States, with a score almost twice as high as in Viet Nam – a country which is often seen as a competitor for investment.

Restrictions on foreign investment are negatively correlated with FDI inflows. Econometric tests using the *FDI Index* suggest that restrictions on foreign investment are associated with lower levels of investment for a given market size. While the link between FDI and restrictions is clear in cases where FDI is prohibited, the same relationship can be found for other types of restrictions such as a limit on the foreign equity share in a Philippine enterprise.

Time to reconsider Constitutional restrictions on foreign investment?

Many FDI restrictions are enshrined directly in the Constitution, rather than in an investment law or sectoral legislation, with the result that reforms have proved very difficult to enact. Constitutional restrictions on FDI were common in earlier decades in certain regions but are now unusual in many parts of the world. Indeed it is often considered best practice to place restrictions in implementing regulations themselves and not even in investment laws in those countries with such laws. The Philippine Constitution includes restrictions on FDI in public utilities, property, mass media and advertising, educational institutions and development of natural resources

Nationalist provisions restricting investment arose in an era when the Philippine government was keen to assert its economic sovereignty; they are now considered by many as outdated and damaging protectionist measures that discourage foreign investments and facilitate rent-seeking by local oligopolists. They are all enshrined in the Constitution. Several options for reform have been considered, including introducing an amendment to the articles of the Constitution concerning foreign ownership by adding where appropriate “unless provided by law”.

Reforming the Constitution, or charter change, has been discussed for almost as long as the 1987 Constitution has been in existence, and calls for change are widespread – from within government, the media, local and foreign chambers of commerce, not to mention internationally from partner countries and international organisations. This first OECD *Investment Policy Review* of the Philippines adds its voice to this chorus, but if the refrain is familiar, the approach to the question is comprehensive and brings in insights from peers in Southeast Asia and elsewhere.

Even without a Constitutional amendment, significant parts of the economy could be liberalised and opened up to foreign investment if specific legislation declared that they were not public utilities. The Constitution provides for a 60-40 nationality requirement on the ownership of public utilities, but public utility is not defined in the law. The outdated *Public Services Act* 1936 does not define public utility *per se*; instead, it details what types of public services operation would need certificates of public convenience and necessity. The minimal capital requirement could also be modified through amendments to the relevant laws.

Liberalising FDI restrictions will enhance the impact of the Competition Act

The positive effects of liberalisation of FDI restrictions would be significant. Aside from opening the Philippines to more foreign direct investment, it would provide a much-needed boost to competition in the Philippine economy in combination with the new *Competition Act*. Together, FDI liberalisation and the new *Competition Act* can provide more of an impulse to new market entry and greater competition than either could achieve alone. As discussed in Chapter 1, small and micro enterprises are more prevalent than medium-sized enterprises in the Philippines, creating a gap in the middle of the country’s industrial structure. With no large cohort of medium-sized local firms willing to enter new markets, the most credible threat to incumbents might come from foreign investors. The resulting stronger competition in public utilities and other sectors would give local consumers access to better services at lower prices. It would also improve the competitiveness of downstream industries dependent on these sectors for inputs.

Permitting more foreign investors to serve the domestic market through a controlling interest in subsidiaries would also allow the Philippines to use the power of attraction of its large and dynamic market. Domestic market-oriented investors are less concerned about the need to compete directly in international markets and hence less influenced by labour costs and quality, incentives and the costs of doing business and more likely to rely on local suppliers for some of their inputs. The lack of linkages between foreign investors and local firms has been a persistent weakness of export-oriented promotion in the Philippines, as in other countries. These new MNE investors could therefore provide a boost to SMEs and help to raise productivity levels in these enterprises. All of this will promote pro-poor growth and inclusiveness.

Foreign direct investment is not a panacea, but in an open economy with contestable markets, it can have a strong impact on growth. All of the many success stories in Southeast Asia have been built in part on attracting FDI. Political turmoil in the 1980s meant that the Philippines missed the first wave of offshoring by firms from Japan and Chinese Taipei. Much of that investment went elsewhere in the region, such as Malaysia and Thailand. As multinational investors now look to adopt a China-plus-one strategy and to reposition themselves within an integrating Southeast Asian market, the Philippines could be well placed to reap the benefits.

Restrictions that belong to a previous era, along with red tape, corruption, insufficiently coordinated promotion activities and the multiplicity of laws regulating the private sector all contribute to the poor investment performance. The Philippines has undertaken many important reforms since the restoration of democracy in the 1980s and these have created a basis for strong economic growth. The recommendations for further reforms which are listed below build on this solid base and, if implemented, will help to place the Philippine economy on a trajectory of sustained and inclusive growth.

This first OECD *Investment Policy Review* of the Philippines describes the reforms that have already been undertaken and their impact on the economy. It looks at several key aspects of the policy framework for investment in the Philippines, including investment policy, the legal protection of investment, investment promotion and facilitation, competition policy, infrastructure investment and responsible business conduct and benchmarks the Philippines against its peers in the region. Certain important elements such as corruption, corporate governance and human resource development are not covered in great detail, however.

The main recommendations from this Review are presented below while more detailed ones are provided in each chapter.

Principal recommendations

FDI restrictions and investment policy

- "Progressive liberalisation of investment with a view towards achieving a free and open investment environment in the region" is one of the guiding principles enshrined in ACIA. The recommendation in this Review to remove restrictions on FDI in the Philippines supports this guiding principle. This Review will not engage in the discussion of how the Constitution should be reformed, whether by introducing a clause allowing restrictions to be determined by national legislation[3] or a more comprehensive reform, although the latter would obviously send a stronger signal to potential investors. At the very least, some reforms could be undertaken more immediately, such as to reconsider the very high minimum capital requirement for foreign investors, which is contained in the *Foreign Investment Act* and the *Retail Trade Liberalisation Act* which would therefore need to be amended. Furthermore, the Constitution already provides for many professional services to be liberalised subject to reciprocity, which should provide the means for some further liberalisation of that sector.

- Beyond the issue of constitutional reform, there is scope for rationalising and modernising the legislative framework for investment. The *Omnibus Investment Code* dates from the same period as the Constitution, and the Foreign Investment Act from the early 1990s. Many ASEAN members have engaged in a frequent process of revising their investment framework. Viet Nam, for example, updated and amended its investment law seven times between when it was first enacted in 1986 and the most recent 2014 investment law. These reforms could cover not only investment restrictions and investor protection, but also investment promotion, as described earlier. Similarly, the regulatory framework for PPPs could be streamlined.

- Policy makers should ensure that positive innovations on investment treaty policy in multilateral ASEAN agreements are reflected in the ongoing review process of the bilateral investment treaties. These innovations include more specific language on key investment protection provisions, such as expropriation and fair and equitable treatment, to ensure that they express government intent and give more direction to arbitrators.

Investment promotion

The proliferation of IPAs and the many laws underpinning them makes effective promotion difficult. Investment promotion and related incentives would benefit from rationalisation.

- Further harmonise investment promotion: In spite of efforts undertaken to bring together 17 IPAs under a coherent investment promotion system, foreign investors are still not provided with a single counterpart. This creates confusion and fatigue among investors and also puts a strain on public resources that have to ensure complementarity of activities and avoid unnecessary duplication. The BOI's role as coordinator of the investment promotion agencies and their activities should be strengthened, but without putting the other agencies at a disadvantage in undertaking their investment promotion activities. This would also strengthen and clarify the reporting lines of the agencies – a critical aspect of effective investment promotion – and will increase their accountability.

- Improve doing business using local solutions: The Philippines showcases a number of good practices in streamlining business regulations and licensing in some of its ecozones. The lessons from PEZA or the Clark Development Corporation should be replicated outside these ecozones. This includes building capacity of the local government units and clearly monitoring the progress of related activities.

- Harmonise the investment incentives system: The large number of laws covering the incentives regime adds to complexity and undermines transparency, thus straining the public administration and confusing investors. International experience suggests having tax administration bodies handling incentives, not least because IPAs face capacity and resource constraints in handling tax matters. The recently enacted *Tax Incentives Management and Transparency Act* (RA 10708) which calls for reporting on the incentives provided to investors and provides for cost-benefit analysis is a welcome step. It should involve the widest possible dissemination of the results.

- The Philippines is ripe for a more elaborate and comprehensive strategy of cluster development. The Department of Trade and Industry (DTI) launched a clusters initiative in 2013 but is encouraged to use the ecozones more in its implementation. Ecozones have demonstrated significant enterprise agglomeration effects, which could be a stepping stone to building dynamic clusters if accompanied by appropriate measures that support critical elements such as industry-guided SME promotion in surrounding areas and collaborative arrangements with competent research and higher education institutions. Financial institutions should be involved in addressing financing constraints of SMEs in these schemes

- Encourage zone developers and managers to promote linkages**:** The mandates of zone developers and managers should be extended to support linkages creation (match-making, facilitating SME-MNE networks etc.), backed by a reward system. Since the new IPP stresses a value chain approach, the IPA network in the Philippines has only recently started addressing the importance of connecting investment and SME promotion, and hence linkages.

- A new Magna Carta for SMEs: The 1991 Magna Carta for MSMEs marked the first major SME legislation in the country, consolidating all SME promotion initiatives into a single institutional framework. Since then, the range of SME promotion activities, both in terms of access to finance and addressing capacity weaknesses, has increased substantially. A cross-cutting challenge of these measures is that SMEs have varied needs for assistance which no single provider can meet, often resulting in a proliferation of frequently overlapping measures and activities. This challenge is not unique to the Philippines, but the DTI and other leading agencies are encouraged to clearly delineate and ensure complementarity between the various SME promotion initiatives. The laudable achievements of the 1991 Magna Carta are needed again today.

Competition policy

The new *Competition Act* is a major step in the reform process in the Philippines; it will now need to be followed up by effective implementation. Key recommendations include:

- Adopt clear and robust implementing rules and regulations to articulate the new Competition Commission's interpretation of the law and avoid the potential negative effects of provisions that are at odds with established best practice.

- Assess the impact of the implementation of the *Competition Act* on reducing entry barriers in key sectors and the degree to which these new entrants are foreign or domestic. Assess the extent to which FDI contributes to a higher degree of competition.

- Address major regulatory barriers to competition by promoting the development of pro-competitive regulatory policies in regulated sectors.

Use the Commission's primacy over competition laws to address competition problems in regulated sectors, such as assuring non-discriminatory access to essential networks and tackling behavioural barriers to entry.

- Adopt policies and procedures to embed transparency, integrity and accountability into the new Competition Commission. Accountability is necessary to maintain independence in the longer term. Stakeholders should know who is responsible for a decision and the reasoning behind it. They should be able to obtain redress easily and quickly if the competition authority has acted arbitrarily or incompetently. Communication and transparency are central to accountability. The new Commission should publish annual reports and financial accounts in line with national reporting requirements, as well as reasoned case decisions.

- Ensure the independence of the new Competition Commission. An independent authority with a specific mandate and predictable decision-making that remains constant through a change of government will be better able to limit the extent that business groups can lobby government agencies for favourable treatment; and it provides business with greater regulatory certainty. Budgetary autonomy can support independence, for example a multi-year budget cycle, if feasible, could enhance the independence of the Competition Commission.

Notes

1. Aldaba (2008).

2. World Bank (2013).

3. The Resolution of Both Houses No. 1 would have eased restrictions on FDI by inserting the phrase "unless otherwise provided by law" in Articles XII, XIV and XVI of the 1987 Constitution.

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Chapter 1

Philippine reform environment: Successes and challenges

This chapter describes major sectoral reforms since the late 1980s and their impact on the overall enabling environment for investment. It then reviews trends in foreign direct investment in the Philippines using a variety of data sources from home and host countries, approvals data and cross-border mergers and acquisitions to provide a full picture of foreign investment patterns. It then looks at key policy reforms covering foreign investment and benchmarks the remaining restrictions against those in other countries.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

The Philippines has reformed significantly at various times since the restoration of democracy in 1986. While previous reform episodes were often associated with crises, the most recent reforms since 2010 have taken place at a time of strong economic growth. Some important sectoral reforms have had an impact on investment, including in telecommunications, water, oil and banking. Together with the earlier privatisation of large swathes of the economy, these reforms have created opportunities for both domestic and foreign investors. The new *Competition Act* (described in Chapter 4) will provide even more opportunities.

In spite of rapid growth recently, the Philippines faces some persistent development challenges. Poverty and income inequality persist and the need to make growth more inclusive was recognised in the Philippine Development Plan (2011-16). There is also a need to expand the manufacturing sector to create jobs for the growing workforce that in the past has sometimes sought opportunities abroad. More broadly, investment relative to GDP is still below what it has been in the past and compared to the performance of other ASEAN members. The poor investment climate in the past can also partly explain the high degree of informality in the Philippines.

Investors have often responded enthusiastically to reforms, both in the 1990s and more recently. FDI inflows are currently at record levels and, partly as a result of the growth of the business process outsourcing sector, employment in US-owned affiliates has doubled in the past five years. Approvals data which represent to some extent future investment commitments have also been at record levels over the past five years, although they declined significantly in 2014. On the other hand, mergers and acquisitions of Philippine enterprises by foreign investors have fallen significantly since a peak in 2007-08 and compared to the late 1990s. This mixed picture from a variety of data sources suggests that it is too soon to tell whether recent trends represent a new growth trajectory for FDI in the Philippines.

The new *Competition Act* and recent sectoral reforms will create new market opportunities for potential investors, including foreign investors, but restrictions on FDI embodied in the 1987 Constitution and the *Foreign Investment Act* still discourage FDI in the Philippines. These include foreign equity limits in certain key sectors, high minimum capital requirements and restrictions on foreign ownership of land. FDI restrictions have come down over time but remain high by regional and global standards – as measured by the OECD *FDI Regulatory Restrictiveness Index* (OECD 2014a).

Liberalisation of remaining FDI restrictions could contribute to higher inflows of FDI in the economy, as restrictions tend to be negatively correlated with FDI inflows. Foreign investment is usually encouraged for its potential contribution of capital, technology and other intangible assets, as well as for the greater access to global and regional exports markets that it provides. Openness to FDI is also associated with increased participation in global value chains which is one of the objectives of the Philippine government. More generally, restrictions on FDI in service sectors can affect the productivity and hence export competitiveness of downstream manufacturers.

The overall policy environment has shaped economic performance

For four decades following independence, the Philippines followed an inward-looking development strategy punctuated by balance of payments crises. Import substitution policies in the 1950s and 1960s managed to generate growth and to attract some foreign investors to produce goods which had already found some acceptance in the local market through trade. The market was not yet saturated, and the Philippines was still a relatively rich economy within the region (OECD 1999). Domestic manufacturing industries expanded, but this growth was not sustained as firms looked inward with access to a small domestic market and relied heavily on preferential treatment. With largely open-ended protection such as renewable fiscal incentives and high tariff walls, infant industries such as the automotive industry[1] failed to become internationally competitive even after four decades. Periodic devaluations of the peso helped to improve exports but inflation caused by loose monetary policies soon eroded their competitiveness. Limited domestic demand soon led to stagnation in the manufacturing sector.

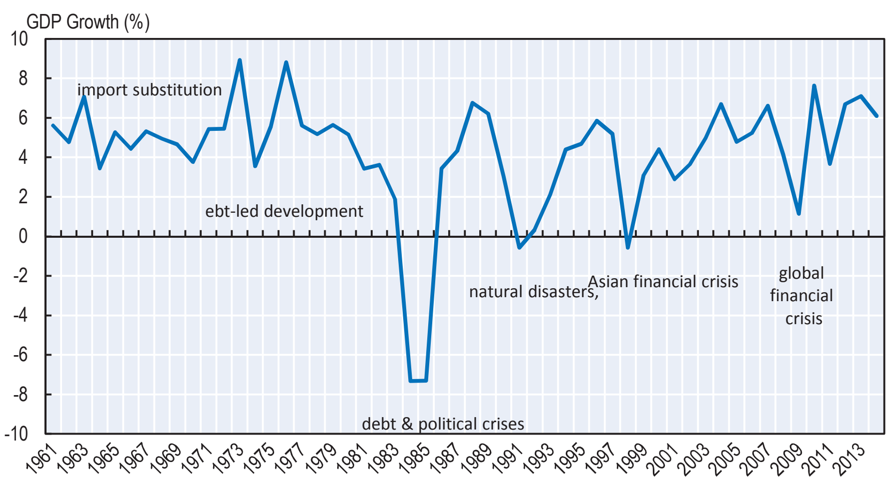
In the 1970s, the Philippines pursued a debt-driven growth strategy and relied heavily on foreign borrowing to boost investment in infrastructure projects, primarily in tourism, as well as to support the expansion of state-owned enterprises under the Marcos regime. While this led to growth in the first half of the decade, subsequent over-borrowing together with political instability and corruption resulted in the country's worst debt crisis from 1983 to 1985. The 1980s are often referred to as a lost decade for Philippine growth: the government declared a moratorium on foreign debt servicing in 1983 and suffered its first recession in the post-war era.

The Philippines has undergone several major reform episodes since the restoration of democracy in 1986. These reforms have been fitful, sometimes involving strong resistance of vested interests through the courts or Congress but they have had a strong impact on performance. Some have been driven by the need to meet IMF or World Bank conditions but mostly they have been based on the government's own assessment of the need to improve performance. Reforms have encompassed trade and investment liberalisation, tax policy, privatisation of government assets, restructuring of government enterprises and most recently competition policy.

The strong growth performance over the past decade, with the exception of the global financial crisis, owes much to these earlier reforms (Bernardo and Tang, 2008). The growth in services trade has been driven by the market reforms introduced in the early 1990s, when structural reforms were introduced in historically sheltered industries, involving the dismantling of powerful groups with deeply entrenched interests in major sectors of the economy. Partial liberalisation in key sectors such as telecommunications and transport, as well as privatisation and deregulation in the water and oil sectors have paved the way for the emergence of more competitive and dynamic sectors in manufacturing and services such as electronics, business process outsourcing and information technology.

Figure 1.1 shows growth in GDP in the Philippines since 1961. Beyond the influence of the evolving development strategies and policy reforms, growth has also been driven by external shocks, such as the Asian financial crisis which brought the country to its third recession in just 15 years, the global financial crisis in 2008 and by natural disasters. A major earthquake hit the central and northern Philippines in 1990, followed by the volcanic eruption of Mt. Pinatubo in 1991 which was severe enough to cause a contraction that year.

Figure 1.1. **Philippines GDP growth rate, 1961-2014**



Source: World Development Indicators, World Bank.

StatLink http://dx.doi.org/10.1787/888933344914

Between 2001 and 2013, the economy grew on average 5%, or 3% in per capita terms, largely driven by consumption. Household consumption since 2008 has exceeded 70% of GDP, mostly on food (42%) and transport (8%), a pattern reflecting low household income.[2] This consumption has been driven in part by strong cash remittance from overseas Filipino workers, which have grown continuously since 1998 to surpass USD 28 million in 2014. The Philippines is the third largest recipient of remittances in the world after India and the People's Republic of China, amounting to USD 23 billion in 2013 or almost 40% of the value of exports and 30% of imports. In contrast, foreign investment inflows averaged less than 2% of GDP between 1980 and 2013. Historically, the Philippine economy has exported labour rather than importing capital.

Since 2000, the Philippine economy has shown a strong growth performance, representing a considerable improvement over previous two decades (Table 1.1). Growth slowed during the financial crisis but has recovered since 2009 due to exports in the electronics industry, growth in business process outsourcing, the real estate construction boom, and private consumption. In 2014, GDP grew at an impressive 6.1%, though lower than the previous year (7.1%).

Table 1.1. **GDP growth rates, 1961-2014**

GDP growth (%)	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010	2011-2014
Philippines	4.9	5.9	1.8	2.9	4.8	5.9
Indonesia	4.2	7.9	6.4	4.4	5.2	5.7
Malaysia	6.5	7.9	6.0	7.2	4.6	5.4
Thailand	9.2	6.9	7.9	4.6	4.4	2.5
Vietnam	na	na	4.6	7.6	6.6	5.7
China	5.0	6.3	9.3	10.5	10.5	8.1
Korea	8.7	9.1	9.7	6.6	4.4	3.0
East Asia & Pacific (developing only)	4.7	6.6	7.5	8.4	9.1	7.5
East Asia & Pacific (all income levels)	8.1	4.9	5.3	3.4	4.1	4.0

Note: Data for Thailand starts in 1966; Vietnam starts in 1985.

Source: World Development Indicators, World Bank.

StatLink http://dx.doi.org/10.1787/888933345188

Structural transformation in the Philippines has been biased towards services

Among the high-performing East Asia economies, dynamic structural transformation has been the main growth engine, as increases in agricultural productivity have paved the way for developing a labour-intensive manufacturing sector followed by a high-skill services sector. In the Philippines, this dynamic transformation from agriculture to manufacturing never occurred. Agricultural productivity has stagnated, manufacturing has failed to grow sustainably and a low-productivity, low-skill services sector has emerged as the dominant feature of the economy.

Much of the growth in past decades can be attributed to services – the economy deindustrialised from the early 1980s and urban growth relied on the services sector. The level of investment stagnated, as the sector required more skilled labour and less capital investment. Instead of continuing the industrial upgrading process as elsewhere in Asia, Philippine industrialisation plateaued. The country transformed itself into a service-based economy, and since the 2000s, has further shifted towards services due to the rapidly growing business process outsourcing (BPO) sector (Table 1.2). Developing the services sector alone is not sufficient to address the development challenges and lead to inclusive growth. Although the BPO sector, characterised by high-skilled and well-paid workers, employed one million people as of 2014, it accounts for just 2% of the total labour force. Service sector employment is mostly comprised of informal or low-skilled workers.

Table 1.2. **Structural change between 1984 and 2014**

Output Structure (% of GDP)

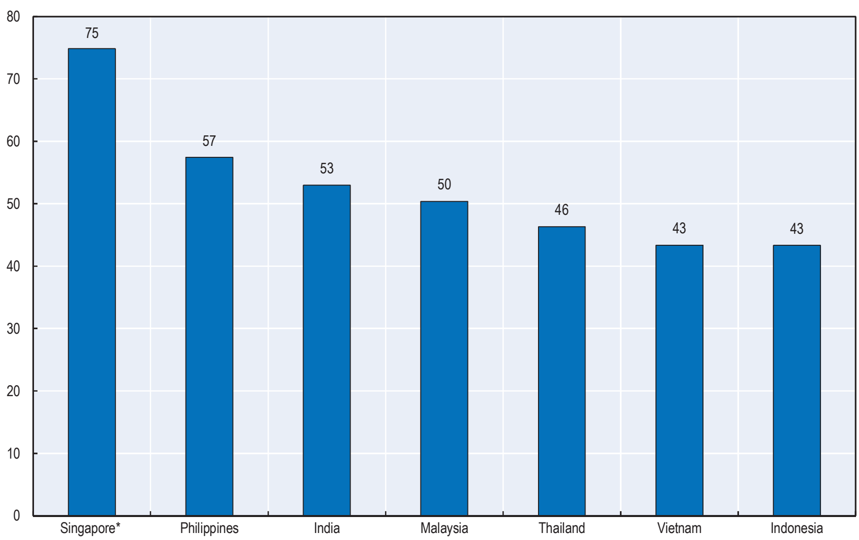
	Philippines			Indonesia			Malaysia			Thailand		
	1984	2014	Change	1984	2014	Change	1984	2014	Change	1984	2014	Change
Agriculture	24.8	11.3	**-13.5**	22.7	13.7	**-9**	20	9.1	**-10.9**	17.6	11.6	**-6**
Industry	37.9	31.2	**-6.7**	39.1	42.9	3.8	38.5	40.5	2	32	42	10
Manufacturing	24.6	20.5	**-4.1**	14.6	21.6	7	19.3	24.0	4.6	22.9	32.6	9.6
Services	37.3	57.5	20.1	38.2	43.3	5.2	41.5	50.4	8.9	50.5	46.3	**-4.1**

Source: World Development Indicators, World Bank.

StatLink http://dx.doi.org/10.1787/888933345193

Within Southeast Asia, the Philippines has the second highest value added in services as a percentage of GDP after Singapore. Except for a few export-oriented crops, the agriculture sector is largely backward and unproductive, and its share of GDP has fallen from 30% to around 10% over the past six decades. The share of manufacturing to GDP peaked at 30% in the early 1970s and gradually declined to about 21% of GDP in 2014. In place of agriculture and manufacturing, the services sector has dominated growth (Figure 1.2).

Figure 1.2. **ASEAN and India services value added (% GDP), 2014**



*Singapore data is from 2013.

Source: World Development Indicators, World Bank.

StatLink http://dx.doi.org/10.1787/888933344929

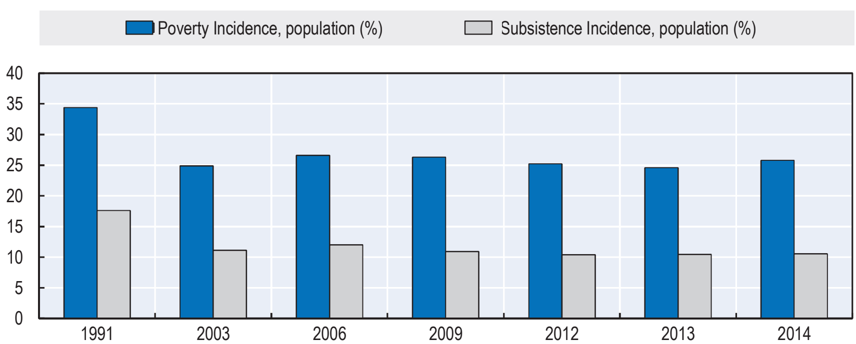
Poverty levels have declined over time, albeit slowly, but inequality is high

> *The goals of the national economy are a more equitable distribution of opportunities, income, and wealth; a sustained increase in the amount of goods and services produced by the nation for the benefit of the people; an expanding productivity as a key to raising the quality of life for all, especially the underprivileged.*

1987 Constitution of the Philippines

As the above quote from the Constitution (Article XII) suggests, income equality has been a long-standing policy goal. In the Philippine Development Plan 2011-16, inclusive growth is defined as “growth that is rapid enough to matter, given the country’s large population, geographical differences, and social complexity. It is sustained growth that creates jobs, draws the majority into the economic and social mainstream, and continuously reduces mass poverty”. Despite rapid recent growth, poverty incidence across the population increased from 24.6% to 25.8% in 2014 (Figure 1.3), attributed to rapidly rising food prices and the effects of typhoon Yolanda. It represents a temporary reversal of the decline in poverty incidence in 2012-13, as higher growth rates had started to lift more people out of poverty compared to the period 2000-09, when poverty incidence barely declined. Poverty ratios in the Philippines are still high compared to a number of East Asian economies, as the slow growth in real GDP in past decades translated into a slower increase in GDP per capita when compared to other ASEAN economies.

Figure 1.3. **Philippines poverty and subsistence incidence**



Source: National Statistics Office, National Statistical Coordination Board.

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The most recent GINI ratio on the Philippines in 2012 reveals high income inequality which suggests that the economic boom has not been broad-based. This income disparity was one of the highest in Asia. By one estimate, in 2011 the 40 richest families on the Forbes wealth list accounted for 76% of the country’s GDP growth.[3] Inequality exists in terms of geography as well, with over 60% of the country’s overall economic growth concentrated in only three out of the seventeen administrative regions: National Capital Region, Central Luzon and Calabarzon Region which together account for one third of the total population.

Bridging this income disparity means translating economic growth into jobs. The labour market is characterised by high unemployment and underemployment, high informality and low real income. The labour force has consistently grown faster than employment over the past decade. Underemployment is a key source of poverty, with 18% of the employed population seeking better quality work. On average, of the 1.2 million potential entrants in the labour force, approximately 22% of workers secure jobs in manufacturing and formal services sector while the rest find jobs in the informal services sector. The Philippine unemployment rate is the highest in ASEAN, ranging from 6.4% to 7.3% since 2010. Among the unemployed, over 40% are post-secondary and college graduates, suggesting a lack of high-skilled jobs in the market.[4]

Most enterprises are small and micro ones, with a high degree of informality

Informality in the Philippines is very high, with informal workers accounting for three out of four jobs, and the average productivity of micro, small and medium-sized enterprises (MSMEs) is very low. Labour productivity in MSMEs is estimated to be only one-third that in Malaysia and one twentieth of that in high-income countries.[5] Philippine MSMEs account for 99% of firms and 60% of employment but contribute only 36% of gross value-added. Small and micro enterprises are more prevalent than medium-sized enterprises in the Philippines, creating a gap in the middle of the country's industrial structure (Table 1.3). Linkages between MSMEs and large domestic and multinational corporations are weak since MSMEs are not integrated into the supply chain; hence growth experienced by large enterprises has failed to spill over to the SME sector.

Table 1.3. **Philippine firm structure**

	Total	Micro	Small	Medium	Large
2008 Number of Enterprises **% distribution**	761 409	697 077 91.6%	58 292 7.7%	3 067 0.4%	2 973 0.39%
2008 Employment **% distribution**	5 544 590	1 663 382 30%	1 314 065 24%	418 058 8%	2 149 085 39%
2008 Value Added (PHP) **% distribution**	2 108 546	103 918 5%	431 340 20%	216 685 10%	1 356 603 64%
2008 Value Added per worker (PHP)	380 289	62 474 4%	328 248 21%	518 313 34%	631 247 41%

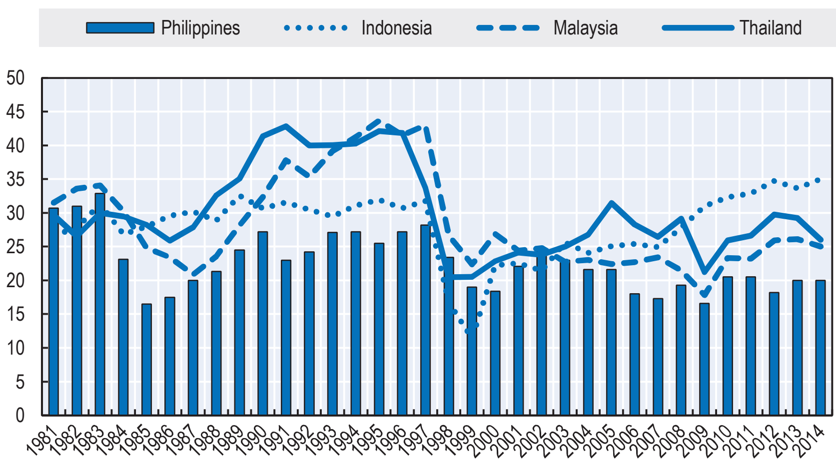
Source: National Statistics Office.

StatLink http://dx.doi.org/10.1787/888933345203

Investment is increasing although weaker than in the 1990s in real terms

Both foreign and domestic investment in the Philippines have risen in nominal terms in the past few years, with FDI at a record high of USD 6 billion in 2014. As a share of GDP over the past decade, investment is nevertheless lower than in other major ASEAN members and well below the average for the 1990s. Market entry barriers, inadequate competition and a high regulatory burden all contribute to the country's low investment-to-GDP ratio compared to other countries in the region. Investment as a share of GDP was high in the early 1980s then peaked again at 28.2% in 1997 before falling to 16.6% in 2009 (Figure 1.4).

Figure 1.4. **Investment to GDP ratios of selected ASEAN Countries, 1994-2014**



Source: World Development Indicators, World Bank.

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Sectoral reforms have brought significant benefits

The liberalisation of existing restrictions on foreign investment in some key sectors, together with privatisation and deregulation, have all contributed to improving the investment. This section provides examples of successful reform processes for key sectors of the economy.

Telecommunications

Telecommunications reform was one of the most important reforms in the 1990s and has contributed to economic growth in the past two decades. Historically, the industry was dominated by a private monopoly for more than half a century, the Philippine Long Distance and Telephone Company (PLDT). It was a regulated monopoly subject to significant regulatory barriers to entry. A congressional franchise and a Certificate of Public Convenience and Necessity or a Provisional Authority issued by the regulator, the National Telecommunications Office, was required prior to entry into telecommunications services and facilities.

The industry was deregulated beginning in 1993 as reforms were initiated by an executive power that challenged the monopoly, owned by one of the country's most powerful oligarchs. This was codified in 1995 with the *Public Telecommunications Policy Act* (RA 7925). The reform process was led by the then President Ramos (1992-98) who supported pro-competition and market-oriented reforms and formed a broad-based coalition with government, business and civil society.

The industry was transformed from a virtual monopoly to a more competitive market and a greatly expanded network at much lower prices and better service. This has facilitated the growth of new non-traditional industries, such as contact centres, back-office support, and other IT or information technology-enabled services. These new industries, collectively known as the BPO industry, have become one of the main drivers of growth in the past two decades. Before its deregulation, PLDT controlled more than 90% of the market and owned the country's only transmission line. The reform resulted in the entry of several players including international investors, and by 2001, the industry had seven players. Revenues grew eleven-fold from PHP 20 billion in 1993 to PHP 230 billion in 2008, or a compounded annual growth rate of 18% (World Bank, 2013). The industry's contribution to value-added increased at a similar pace. Ironically, PLDT emerged as the biggest beneficiary of the reform, earning much higher revenues arising from a much bigger market. Employment also increased in the telecommunications industry and much more in the industries that depended on it, such as BPOs.

The BPO industry is a prime example of a dynamic industry that has benefited tremendously from the liberalisation of telecommunications. Over the past decade, it has grown at an average of 24% annually, with revenues reaching USD 15.5 billion and direct employment of 850 000 in 2013. Call centres accounted for 60% of total BPO revenues and of total employment in the sector as of 2013. Firms from the United States, United Kingdom, Netherlands, Germany and France have been the largest investors, primarily in the contact centre and software development sub-sectors. In recent years, BPO growth has begun to shift from contact centres to more knowledge-based businesses, such as back office systems development, accounting, medical transcription, and animation. Revenue growth in these non-voice

BPOs ranged from 40-100%. Even during the recent global economic slowdown, the BPO industry has continued to expand.

Table 1.4. **Information Technology – BPO, sales revenue by category**

IT-BPO Category	SALES REVENUE Levels (in US$ million)									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Contact Center	587	986	1455	2051	2839	4207	5260	6817	7587	8394
Transcription	4	8	20	33	34	57	84	122	198	423
Animation	12	17	26	29	36	52	63	72	80	88
Software Development	279	399	707	1098	1413	1672	2198	2469	2848	3429
Other BPOs	441	585	697	1157	2004	2270	2452	2594	2736	2971
TOTAL INDUSTRY	**1324**	**1996**	**2906**	**4368**	**6325**	**8258**	**10058**	**12074**	**13450**	**15305**

Source: Central Bank of the Philippines, 2013 Survey of IT-BPO Services

StatLink http://dx.doi.org/10.1787/888933345211

Table 1.5. **Information Technology – BPO, employment**

IT-BPO Category	EMPLOYMENT Levels (count in persons)									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Contact Center	65006	96246	153683	169748	212372	255765	329597	433183	487757	530882
Transcription	901	1785	4956	6621	4321	7060	9131	11084	16997	20172
Animation	1488	1864	4482	4323	5656	3732	3908	3973	4164	4206
Software Developmen	11975	17829	42657	44870	49893	46987	49516	55464	64922	82583
Other BPOs	15118	20278	42267	45994	82893	131267	143975	175761	196092	213939
TOTAL INDUSTRY	**94488**	**138002**	**248045**	**271556**	**355135**	**444811**	**536128**	**679464**	**769932**	**851782**

Source: Central Bank of the Philippines, 2013 Survey of IT-BPO Services.

StatLink http://dx.doi.org/10.1787/888933345220

Table 1.6. **IT – BPO, foreign investment by category and source, 2013**

IT-BPO Category	USA	Europe [1]	Asia [2]	Australia	Japan	India	China	Total FDI
Contact Center	1570	1520	71	72	4	83	0	3321
Transcription	68	3	0	24	-6	0	0	89
Animation	-2	0	-13	0	91	0	0	76
Software Development	248	1458	21	-1	205	1	6	1938
Other BPOs	290	393	212	74	413	118	0	1499
TOTAL INDUSTRY	**2174**	**3375**	**291**	**169**	**707**	**202**	**6**	**6924**
Percent Share	**31.4**	**48.7**	**4.2**	**2.4**	**10.2**	**2.9**	**0.1**	**100.0**

1. refers to United Kingdom, Netherlands, Germany and France
2. refers to Singapore; Hong Kong, China; and Korea.

Source: Central Bank of the Philippines, 2013 Survey of IT-BPO Services.

StatLink http://dx.doi.org/10.1787/888933345239

Water

As in the telecommunications industry, the water industry was dominated by one key player, the Metropolitan Waterworks and Sewerage System (MWSS), which was in charge of water service delivery in Metropolitan Manila. Declaring a water crisis in 1993 and convening a Water Summit in 1994, President Ramos used the crisis as a platform to push for reform and the possibility to privatise the sector. In order to implement the reform, the president sought legislators' approval of a *National Water Crisis Act* that would give him emergency powers to solve the water crisis. This was passed in June 1995, after which the Ramos administration sought to reduce potential opposition to the reform through programmes that would promote inclusiveness and participation.

In 1997 two concession contracts for eastern and western Metro Manila were awarded after an open competition. At the time, these concessions represented the largest population served by private operators in the developing world. The winning companies were Maynilad Water Services for the west Manila concession and Manila Water Company for the east Manila concession. To facilitate the public-private partnership and to promote transparency and fair competition, the government brought in the IFC to act as lead advisor for the privatisation, designing the operating agreement and overseeing the bidding process for the concessionaire.

In terms of impact, prior to privatisation in 1996, MWSS had water coverage in only two thirds of Metro Manila. Privatisation resulted in the following improvements: (a) expanded service delivery in terms of population coverage and water availability, Manila Water has increased water access to 99% of the population it covers on the east side, while Maynilad services 90% of the population in its service area; (b) increased operational efficiencies, most notably in the east zone where non-revenue water has dropped dramatically; (c) less politicised rate setting; and (d) reduced reliance on government to fund MWSS budget shortfalls and needed capital expenditures.[6]

Air Transport

Air transport reform has also had a significant impact on the economy in terms of reducing prices and creating jobs in the trade and tourism sectors. Similar to the telecommunications industry, the airline industry was a virtual monopoly before 1995, when it was dominated by Philippine Airlines.

To spearhead policymaking for the passenger airline industry, the government passed the *Civil Aeronautics Act* (RA 776) in 1952. It gave the Civil Aeronautics Board (CAB) and the Air Transportation Office (ATO) the authority to promote adequate, economical and efficient passenger airline service and those of other carriers at reasonable charges and promote competition between passenger airlines and other carriers to the extent necessary in order to ensure the development of the Philippine air transport system. CAB administers the economic regulation of the industry while ATO supervises technical aspects. The government liberalised the domestic and international airline industry in 1995 under Executive Order (EO) 219, opening the market to more competition. Restrictions were removed on routes and flight frequencies, as well as government control on fares and charges. On market entry, the provision encourages at least two operators in any route and operators are free to leave any unprofitable routes. With regard to fares, markets with at least two operators are deregulated, while regulation still applies in single-airline markets.

This reform was part of a broader civil aviation reform to address issues such as airport congestion in Manila, poor performance of international tourism, and inefficiencies in the domestic aviation market. For domestic aviation, where the reform was the most successful, the government allowed new domestic airlines to operate freely and to complement or establish new routes. This led to a threefold increase in the number of domestic airline routes. Moreover, up to six airlines entered the market between 1995 and 2010. The degree of competition reached a high point in 2011, when the new players' combined market share reached almost 60% (World Bank, 2013).

Banking

In the past two decades, the Philippines has adopted a number of economic policy reforms aimed at liberalising and internationalising its domestic financial markets. It has relaxed or removed barriers to international investments and eased barriers to international capital flows. An important subset of these reforms has centred on liberalising restrictions on foreign involvement in the domestic banking market. This liberalisation has been of two general forms: regulations that allow the entry of foreign-controlled banks and regulations that provide incentives for foreign ownership of the common stock of domestic banks.

The most significant of these regulations is the *Foreign Bank Liberalisation Act* (RA 7721) passed in May 1994 which allowed additional foreign banks to operate in the Philippines and for foreign banks to acquire up to 60% of an existing domestic bank. The act was intended to change the competitive landscape of the Philippine banking sector through an influx of foreign competition which was expected to prompt sounder banking practices. Prior to the passage of the Act, only four foreign banks had been allowed to operate a branch or branches in the Philippines. Subsequently, ten new foreign commercial banks began operations in the Philippines in

1995 using the first entry mode, which was the establishment of branches with full banking authority, while four foreign banks began operations in the Philippines between 1995 and 1998 using the second entry mode which allowed 60% ownership of any new Philippine banking subsidiary.

Access to finance remains an important challenge in the Philippines. According to the World Bank's *Global Findex* database (2014), only 28% of adults have an account at a financial institution, compared to 36% in Indonesia, 78% in Thailand and 81% in Malaysia. The geographical dimension is partly to blame as the archipelago characteristic induces further the concentration of services in higher income and populated urban areas. Estimates from the Central Bank show that around 37% of the municipalities, representing 15% of the population, do not have access to formal banking offices. Access to finance for SMEs is also an acute challenge. Domestic credit to GDP stands at 39%, roughly three to four times less than in Malaysia, Thailand and Singapore. In the World Bank *Doing Business* ranking, the Philippines is ranked 109th with the regards to the ease of getting credit, compared to Indonesia (70), Malaysia (28) and Thailand (97).

The relatively limited competition in the banking sector, partly due to the restrictions imposed on foreign bank entry and ownership until recently, has likely been a significant barrier for improving access to finance in the country. The 1994 Republic Act 7721 was amended in May 2014 by RA 10641 which fully liberalises the sector, allowing foreigners to own up to 100% of domestic banks and facilitating the entry of established, reputable and financially sound foreign banks in the Philippines. It also grants locally-incorporated subsidiaries of foreign bank the same banking privileges as domestic banks of the same category. Under the new law, foreign banks may operate in the Philippine banking system through any one of the following modes of entry: (*i*) by acquiring, purchasing or owning up to 100% of the voting stock of an existing bank; (*ii*) by investing in up to 100% of the voting stock of a new banking subsidiary incorporated under the laws of the Philippines; or (*iii*) by establishing branches with full banking authority.

Past evidence has been relatively positive in the case of the Philippines with regards to banking reforms promoting the entry of new competitors. When it opened up the sector to foreign participation in 1994, allowing up to ten new foreign banks to establish in the country, although limiting their ownership to up to 60% of the voting capital, competition from foreign-owned banks substantially increased. While in 1994, there were only four foreign-owned banks operating in the country (as they had been present prior to 1948), in 1995 the number jumped to 14. Domestic banks reacted by trying to improve their efficiency to compete with the new entrants. The evidence suggests that foreign bank entry was associated with a decrease in interest rate spreads, and compelled domestic banks to improve their operational efficiency, most notably in the case of banking institutions associated with family business groups (Unite and Sullivan, 2003). The Asian financial crisis and regulatory reforms in the late 1990s and early 2000s, including the moratorium on new commercial banking entry implemented in 2000 the *General Banking Law* (RA 8791), also further consolidated in the industry.

Nevertheless, despite improvements since the late 1990s, and more notably since the global financial crisis, the Philippines banking sector remains largely fragmented and competition from foreign-owned banks remains limited. As of December 2014, there were 648 operating banks in the country (39 universal banks; 69 thrift banks and 543 rural and co-operative banks), down from 996 operating banks in 1998 (Central Bank, 2014). Likewise, participation from majority foreign-owned banks amounted to only 9.3% of the industry's total assets by the end of 2014, much below the 40% ceiling approved in the 2014 reform, and below the preceding ceiling of 30% established in 1994. The full impact of the reform will only be seen over time, but, as with the previous reform, the most recent measures are likely to boost not only FDI in the sector but also the overall performance of the sector as a whole. According to the latest IMF *Philippines Country Report* (2015), as of September 2015, the Central Bank has already allowed the entry of five foreign banks, representing a major step towards enhancing banks competitiveness and facilitating the development of capital markets in the country.

The entry of foreign banks is expected not only to increase competition in the sector, but to also reduce concentration risks and help ease the financing of infrastructure projects. Foreign banks can also facilitate further foreign direct investments into the country from partner companies and support the transfer of technology and know-how between foreign and domestic firms. Box 1.1 discusses recent mergers and acquisitions activities in the Philippines.

Empirical evidence points to several potential benefits of a more contestable banking sector: foreign bank presence is associated with lower costs of financial intermediation, as well as lower rents; increased access to financial services, even for SMEs; enhanced corporate governance and know-how spillovers; improved regulation and supervision; and greater financial stability as foreign banks are generally more capable of absorbing shocks in the host market. Foreign banks also contribute to reduce connected lending as they are usually not as politically-connected as local banks (Claessens and Van Horen, 2012).

Box 1.1. **Recent M&A deals in the banking sector, 2012-2015**

The pressure of new foreign entry is already leading domestic banks to consolidate and raise capital levels, partly also in preparation for more stringent capital requirements under the new Basel III framework (Central Bank, 2014). Several domestic M&A deals were closed in recent years, including some important Philippine banks. The Philippines National Bank acquired Allied Banking Corp in 2013; the Union Bank of the Philippines bought City Savings Bank; the China Banking Corp acquired Planters Development Bank, and the Banco De Oro Savings bought Citibank Savings in 2014. In 2015, the bank also acquired One Network Bank, the largest rural bank in the country.[7] Banks have also raised capital to strengthen their competitive base. The Philippine Bank of Communications closed a share purchase deal with Lucio Co in 2014; the LT Group raised its controlling stake in the Philippines National Bank by acquiring significant direct and indirect stakes at the bank stock rights offering, and the Rizal Commercial Banking Corporation closed an equity investment from Chinese Taipei's Cathay Life Insurance in early 2015.

Despite the sectors' major liberalisation, foreign banks seem to have shied away for the moment from the M&A route to enter the country. Only Cathay United Bank sought to enter the market by the M&A route since the reform, acquiring a 20% stake into RCBC. A number of mid-to-large domestic banks have large family shareholdings, which make it more difficult for investors to obtain control (FinanceAsia, 2014).

Oil

The *Oil Deregulation Act* (RA 8479) was passed in 1998 to liberalise and deregulate the downstream oil industry, in order to inject competition in the petroleum market and attract new players in the industry. It seeks to achieve "a truly competitive market" with fair prices and a suitable supply of environmentally-clean and high quality petroleum products. In order to alleviate public concern on the possibility of spiralling prices after the deregulation, the government launched a nationwide public information advocacy to educate people about the market. Public approval was crucial to get the congressional support to pass the legislation. Another critical element of success was in terms of coalition or consensus building across the different branches of government (Bernardo and Tang, 2008). To date, the benefits of oil deregulation include the following: (*i*) increased competition in the industry with the entry of new players; (*ii*) less politicisation of oil pricing; and (*iii*) proper market response to high oil prices, including conservation and the search for substitutes like biofuels.

Retail

Historically, the Philippine retail industry has undergone two major policy changes. In 1954, the *Retail Trade Nationalisation Act* (RA 1180) was passed, restricting the previously open retail sector to Philippine nationals. This protectionist regime was partially overturned in 2000 with the *Retail Trade Liberalisation Act* (RA 8762) which opened the door to entry of foreign investment in specified areas of retail trade. Foreign investors are now allowed to enter the retail business and own 100% with a minimum of USD 7.5 million in equity (reduced to USD 2.5 million in March 2002). A lower minimum capitalisation threshold (USD 250 000) is allowed for foreigners seeking full ownership for sales of high-end or luxury products. RA 8762 also allowed foreign companies to engage in rice and corn trade. In the same year, the government passed the *E-Commerce Law* (RA 8792), providing for legal recognition of electronically transmitted messages, documents, and signatures, so as to facilitate and encourage domestic and international transactions conducted over the internet.

Foreign direct investment performance and structure

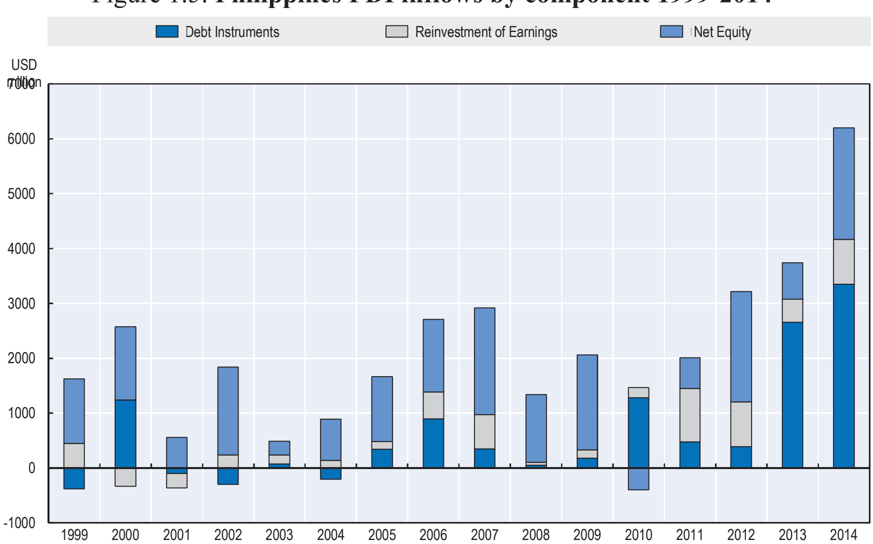
In spite of the many locational advantages offered by the Philippines to potential investors, it has traditionally under-performed relative to many peers in Southeast Asia in terms of attracting foreign direct investment. FDI performance improved in 2014 but both foreign and domestic investment as a share of GDP are low by both regional and historical standards. This section looks at trends in foreign investment in the Philippines. Obtaining a full picture of investment performance in the Philippines can be difficult because of data gaps, particularly the absence of disaggregated FDI data for stocks and for both intra-company debt and reinvested earnings which together have constituted one half of all inflows over the past decade. Since the statistics on FDI in the Philippines do not yet fully match the standards of many OECD countries, this section will also draw on many other potential sources of information, including home country FDI and MNE activity data for their investments in the Philippines, statistics on approvals by the various Philippine investment promotion agencies, and data on cross-border mergers and acquisitions (M&As).

A comparison between FDI inflows reported by Bangko Sentral ng Pilipinas and the corresponding outflows from OECD home countries suggests an overall trend that is not dissimilar despite existing data gaps and constraints in the Philippines' statistics. While the Philippines has made great progress in implementing an integrated approach for reporting FDI statistics through their Foreign Investments Information System (FIIS) which follows the OECD benchmark definition, further improvements would be useful to enrich policy discussions and improve promotion in the Philippines. These improvements should cover not only inflows but also outflows. The FIIS currently covers only inward FDI in spite of the fact that that investment outflows (USD 7 billion) actually exceeded inflows (USD 6.2 billion) in 2014 (Figure 1.9). Regularly reporting outflow information would be beneficial as Philippine enterprises are increasingly investing abroad. More information on the sources and methodologies of FDI statistics in the Philippines is found in the annex.

The most recent FDI figures for 2014 show inflows at historically high levels, amounting to USD 6.2 billion, representing a doubling of inflows every two years since 2010 (Figure 1.5). Over half of this FDI in 2014 was in the form of intra-company debt, referring to net placements of foreign investors in debt instruments issued by local affiliates. Since 1999, 54% of FDI has been through equity, 31% through intra-company debt and only 15% through retained earnings.

As a share of GDP, however, inflows are roughly back to what they were in 2006, and less than they were throughout much of the 1990s and even late 1980s (Figure 1.6). The ratio of FDI stock to GDP in the Philippines of 20% in 2014 is the lowest among all ASEAN countries and compares to an ASEAN average of 68% for that year.

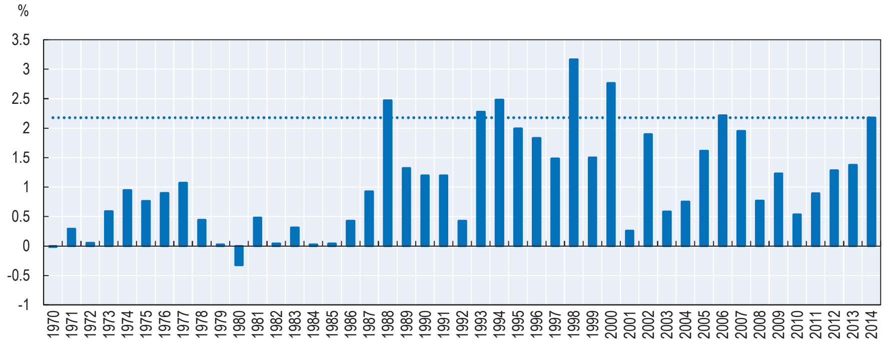
Figure 1.5. **Philippines FDI inflows by component 1999-2014**



Source: Bangko Sentral ng Pilipinas. (BPM5: 1999-2004, BPM6: 2005-2014).

StatLink http://dx.doi.org/10.1787/888933344951

Figure 1.6. **FDI inflows in the Philippines as a share of GDP**



Source: World Bank *World Development Indicators.*

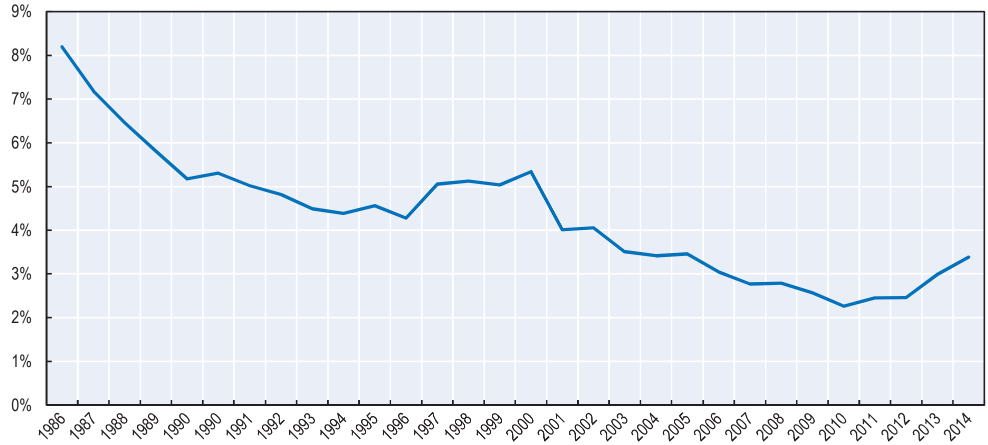
StatLink http://dx.doi.org/10.1787/888933344961

The relative performance of the Philippines in attracting FDI

Foreign direct investment has been significant for most ASEAN economies, and the region as a whole has the highest ratio of FDI to GDP among developing regions. The Philippine share of this investment declined steadily from the mid-1980s until 2010, with the exception of the Asian financial crisis in 1997 which hit neighbouring countries harder than it did the Philippines. The past few years have seen a sustained reversal of this trend, but the Philippine share of the total stock of FDI in ASEAN is still only 3.4% (Figure 1.7).

The decline in the relative attractiveness of the Philippines is even more pronounced if one looks at the stock of investment from its largest investor, the United States. US investment in the Philippines was significant in the 1950s, as US investors established wholly-owned foreign subsidiaries in light manufacturing sectors such as textiles, pharmaceuticals, household appliances, car assembly, tyres and food products. By the 1960s and early 1970s, however, new inflows of foreign investment were reduced as the market became saturated, economic policies became more nationalistic and the preferential access for US firms in the Philippines expired.[8] Except for a brief spurt after 1974, this pattern continued until the present, particularly with an increase in US investment in other ASEAN countries and in China (OECD 1999). As a result, the Philippine share of the stock of US FDI in Southeast Asia has declined from over one third in 1969 to only 1.1% today. While the high share in the early 1970s was clearly not sustainable as more and more countries in the region opened up to foreign investment, there has as of yet been no reversal of this downward trend.

Figure 1.7. **Philippines Share of ASEAN FDI stock, 1990-2014**



Source: UNCTAD.

StatLink http://dx.doi.org/10.1787/888933344974

Figure 1.8. **US MNE employment in selected ASEAN Member States**
(thousands)

Source: United States Bureau of Economic Analysis.

StatLink http://dx.doi.org/10.1787/888933344981

When one looks at activity data for US-owned affiliates in the Philippines, the picture is brighter. Employment by US investors in the Philippines has grown rapidly and now exceeds that of any other ASEAN member state for US investors (Figure 1.8). US affiliates in the Philippines employed 230 000 workers as of 2013 (of which 220 000 were in majority-owned affiliates), after a decade of rapid growth in levels. The Philippines ranked fifth by this measure in the region as recently as 2005. Much of this growth has not occurred in manufacturing where the Philippines still ranks fifth in ASEAN but rather in information and other industries, primarily BPO (Table 1.7).

Table 1.7. **Employment by majority-owned affiliates of US MNEs (thousands)**

	Indonesia	Malaysia	Philippines	Singapore	Thailand
All industries	117	155	**220**	179	175
Mining	25.4	3.3	**0.1**	3.4	3.4
Manufacturing	67.5	107.9	**65.8**	68.7	111.9
Food	8.2	2.2	**1.4**	0.8	14.2
Chemicals	5.6	3.9	**2.2**	8.2	10.2
Primary & fabricated metals	(*)	1.0	**(1-2.5)**	1.2	1.2
Machinery	0.8	3.4	**0.3**	8.2	5.1
Computers & electronic products	3.6	79.6	**34.4**	34.7	48.0
Electrical equipment, appliances etc.	(0.5-1)	(2.5-5)	**2.8**	1.9	0.5
Transport equipment	0.9	2.9	**5.2**	4.7	12.0
Wholesale trade	2.5	5.4	**3.4**	19.7	7.3
Retail trade	0.2	0.9	**2.1**	0.8	3.6
Information	0.4	1.9	**48.0**	8.0	0.5
Finance and insurance	5.4	5.2	**(5-10)**	19.7	5.3
Prof., scientific & technical services	0.3	5.4	**18.3**	10.8	6.2
Other industries	15.4	24.5	**(50-100)**	47.8	36.6

Source: United States Bureau of Economic Analysis.

StatLink http://dx.doi.org/10.1787/888933345249

FDI by sector

By sector, the largest share of FDI inflows has traditionally been in manufacturing, followed by utilities (electricity, gas and water), finance and insurance and real estate. Table 1.8 shows the sectoral disaggregation based on net equity flows and Figure 1.9 for total FDI inflows. The sharp rise in FDI inflows in the service sector in 2014 occurred in the finance and insurance industries. The impact of financial liberalisation on investment in the banking industry is described in Box 1.1. Long-term trends are sometimes difficult to discern because of net outflows in some sectors in some years, but foreign investment in services while volatile has nevertheless been growing.

The growth of FDI in services has been encouraged by the policy reforms described earlier. The deregulation of major utility sectors such as water, telecommunications and transport under the Ramos administration (1992-98) led to an increase in FDI in these areas. Financial sector liberalisation attracted foreign capital inflows during the second half of the 1990s. Foreign investment in the real estate industry has grown in response to the emerging needs of the BPO sector driving demand for office space coupled with an increase in residential housing demand. Investment in the mining sector was prominent following the 1995 *Mining Act* but has declined in relative importance since 2000.

Figure 1.9. **Philippines net FDI by sector, 1999-2014**

Note: Net FDI refers to refer to non-residents' net equity capital (*i.e.* placements less withdrawals) + reinvestment of earnings + debt instruments (*i.e.* net intercompany borrowings).

Source: Bangko Sentral ng Pilipinas

StatLink http://dx.doi.org/10.1787/888933344996

The top five sectors for greenfield projects, in the past decade have been business services with 211 projects, software and IT services (84), and 151 projects combined in food and beverages, financial services and metals. In terms of capital expenditure, the metals, coal and oil and natural gas sectors have been the top three.

Table 1.8. **Net equity inflows of FDI by sector, 1999 - July 2015**

USD million

INDUSTRY / SECTOR	1999-2004	2005-2009	2010	2011	2012	2013	2014	Jan-June 2015	Total 1999-2015	
Agriculture, forestry, fishing	0	5	2	4	9	17	5	0	47	0.2%
Mining & quarrying	126	348	282	- 240	34	44	159	2	1 229	4.1%
Manufacturing	1 580	2 689	-1 275	119	1 770	216	209	367	9 945	30.5%
Electricity, gas, water	27	1 508	- 15	- 22	- 16	434	- 82	45	3 411	10.1%
Construction	60	307	- 2	28	9	2	6	2	780	2.2%
Trade, vehicle repair	57	43	32	31	202	24	99	56	644	2.9%
Transport, storage, communications	478	- 48	106	265	24	27	103	27	1 412	5.3%
Hotels & restaurants	0	23	106	3	3	7	18	4	186	0.9%
Financel & insurance	437	610	60	222	- 200	- 377	1 321	116	3 235	11.8%
Real estate	92	617	182	135	164	70	154	- 11	2 112	7.5%
Services	116	- 53	112	7	17	201	44	45	551	2.6%
Others, not elsewhere classified	2 701	1 371	13	6	- 11	0	0	0	8 153	21.9%

Source: Bangko Sentral ng Pilipinas

StatLink http://dx.doi.org/10.1787/888933345251

FDI by source country

By source country of FDI equity inflows over the past decade, over 70% (USD 8.6 billion) of cumulative inflows have originated from the United States, Japan and Hong Kong, China. Recent foreign investors have also come from China, Germany, the United Kingdom, Australia, Chinese Taipei, Korea, and ASEAN Member States (Table 1.9)

Table 1.9. **FDI in the Philippines by country**

USD million

	1999-2004	2005-2009	2010	2011	2012	2013	2014	Jan-June 2015	TOTAL
USA	1189	2088	229	225	554	-653	1175	558	5364
Japan	1182	1625	247	367	146	438	117	35	4157
Hong Kong	124	823	216	100	655	-86	394	10	2235
United Kingdom	531	400	-21	-22	48	-9	142	24	1093
Australia	18	1	1	2	242	3	71	0	338
Germany	-456	88	18	13	8	22	49	41	-216
ASEAN	571	134	44	43	-62	-42	79	28	796
Korea	16	63	7	21	4	2	5	0	118
Chinese Taipei	17	9	17	11	0	4	50	5	114
People's Republic of China	65	-1	0	1	0	6	41	0	112
All Others (Including countries not specified)	2416	2190	-1154	-203	410	979	-88	-47	4502
Total Net Equity	**5673**	**7420**	**-396**	**558**	**2006**	**664**	**2035**	**654**	**18613**
Total Reinvestment of Earnings*	**401**	**1453**	**182**	**973**	**819**	**420**	**819**	**385**	**5451**
Total Debt Instruments*	**329**	**1822**	**1284**	**477**	**391**	**2654**	**3347**	**981**	**11284**
TOTAL FDI	**6403**	**10695**	**1070**	**2007**	**3215**	**3737**	**6202**	**2019**	**35350**

Notes: Data from 1999-2004 is according to BPM5; data from 2005-2015p is according to BPM6; 2015 reflects preliminary data from January-June. *Country breakdown statistics are not available.

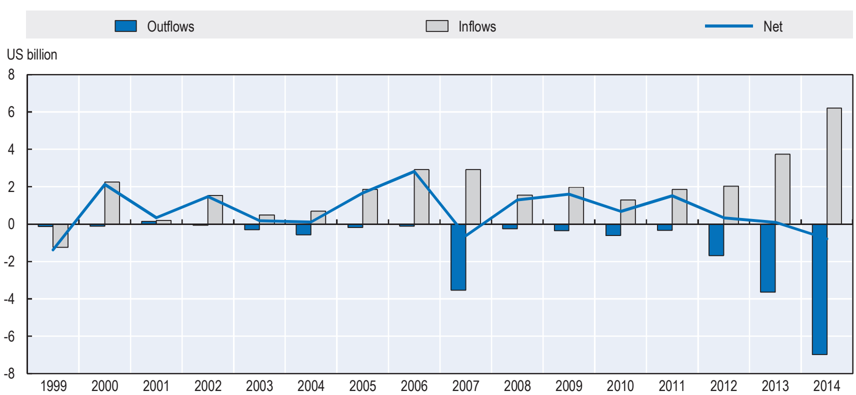
Source: Bangko Sentral ng Pilipinas.

StatLink http://dx.doi.org/10.1787/888933345261

Net FDI flows from the Philippines

While the Philippines is a net recipient of FDI overall, FDI outflows have been increasing rapidly and exceeded inflows in both 2007 and 2014 (Figure 1.10). As discussed in the next section on cross-border M&As, it is unusual for an economy at the level of development of the Philippines to be a major outward investor. At the very least, it suggests that some large Filipino conglomerates have emerged in certain sectors of the economy and that they are building on their market power at home to expand abroad. How this development influences the policy stance towards inward investment in the Philippines and towards international investment agreements remains to be seen.

Figure 1.10. **Net FDI flows from the Philippines, 2000-2014**
USD billion



Source: UNCTAD.

StatLink http://dx.doi.org/10.1787/888933345003

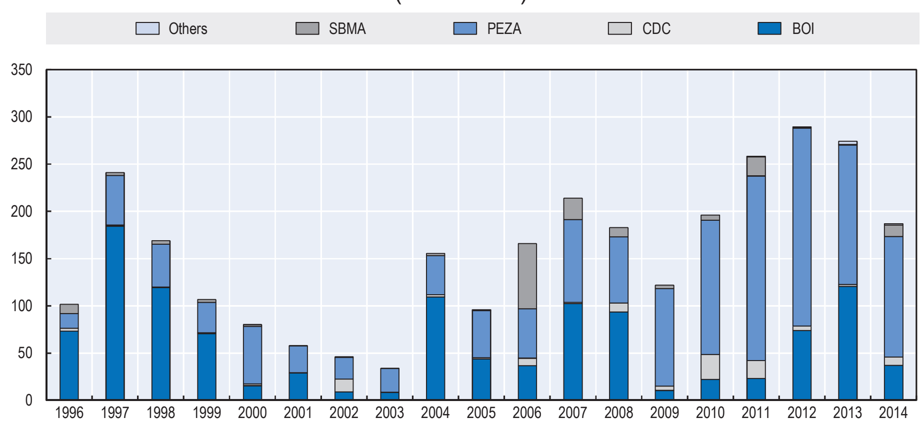
Foreign investment approvals

Figure 1.11 presents the distribution of approved foreign investment by agency. Approved foreign investment refers to the foreign share of proposed projects in the country as approved and registered by the different agencies. Approved foreign investments do not represent actual investments generated but rather foreign investment commitments which may materialise in the near future. Approved investments may be in the form of equity, loans and re-invested earnings. For all approved foreign investments from 1996 to 2014, over 90% were accounted for by two agencies: the Philippine Economic Zone Authority (PEZA) with 51% of the total, followed by the Board of Investments (BOI) with 40%. Since 2009, the PEZA share has been 71%, reflecting in part the quality of its one-stop-shop service (see Chapter 3).

Approved investments reflect primarily export-oriented projects qualifying for incentives. The trend is slightly different from that of overall FDI inflows because it represents commitments not actual investment and because it generally does not captures investment geared to the domestic market such as in the financial sector or many other services. Approved foreign investments actually show a drop in 2014 which should be reflected in future FDI statistics in the Philippines.

Figure 1.11. **Approved foreign investment by investment promotion agencies**

(PHP billion)



Note: BOI: Board of Investments; CDC: Clark Development Corporation; PEZA: Philippine Economic Zone Authority; SBMA: Subic Bay Metropolitan Authority; Others are CEZA: Cagayan Economic Zone Authority; BOI-ARMM: Autonomous Region of Muslim Mindanao; AFAB: Authority of the Freeport Area of Bataan.

Source: National Statistics Office

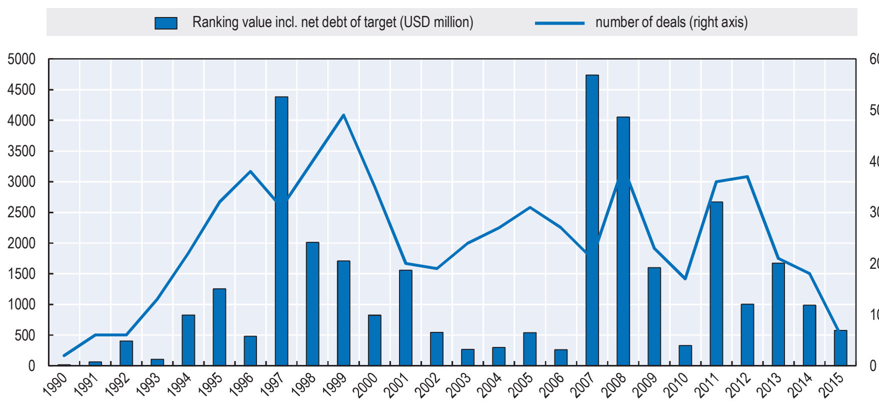
StatLink http://dx.doi.org/10.1787/888933345017

Cross-border mergers and acquisitions involving Philippine companies

A high share of foreign investment in mature markets takes place through acquisitions, particularly when the investor is interested in access to the domestic market. In the Philippines in the statistics for approvals shown earlier, a high share of the total represent greenfield investments or expansions by export-oriented firms in export zones. Data from mergers and acquisitions (M&As) can sometimes provide a complementary image of investment trends by capturing a greater share of those foreign investors interested in serving the Philippine market.

Cross-border M&A peaked in the late 1990s, with a few larger deals in the metals & mining, food & beverage and telecommunications industries accounting for most investment in value terms (Figure 1.12). Subsequently investors' appetite for potential acquisitions in the Philippines declined considerably, partly as a consequence of the impact of the Asian financial crisis and the region's economic prospects. By 2003, cross-border M&A started to recover, jumping to a new pre-global financial crisis peak in 2007-08, with a few large deals in the power, telecommunications, oil & gas and food & beverage industries. Cross-border mergers in the business services and computer-related services industries accounted for roughly 70% of the total number between 2003 and 2008.

Figure 1.12. **Inward cross-border M&A activity in the Philippines, 1990-2015**



Notes: Data refers to cross-border deals completed until 31/07/2015. Only completed deals where the foreign acquirer's share ownership in the target company exceeds 10% are included. This threshold is used as a proxy for FDI, since it denotes a lasting interest in the target company as defined in the OECD Benchmark Definition of Foreign Direct Investment (2008). The database covers 640 deals, but transaction values are only available for 361 deals. The number of deals reflected in the chart includes those for which information on the transaction value is not available.

Source: Thomson Reuters One database.

StatLink http://dx.doi.org/10.1787/888933345028

Since the global financial crisis, cross-border M&A activity in the Philippines has dissociated itself from the overall pattern observed in FDI flowing into the ASEAN region. After a quick and short rebound in the aftermath of the crisis, cross-border M&A activity in the Philippines has steadily declined both in value terms and in the number of deals, whereas FDI figures for ASEAN countries have continued to increase after rebounding from the crisis, reaching an historic high in 2014. In the case of the Philippines, the mismatch is largely a consequence of an uptake in greenfield FDI in the period as shown in UNCTAD's greenfield FDI database (UNCTAD, 2015).

Structural reforms undertaken in the late-1980s in the Philippines spurred economic growth on a par with Asian tigers in the early 1990s and led to a surge in FDI inflows during the decade (OECD, 1999). Deregulation and liberalisation, as well privatisations during the decade, boosted cross-border M&A deals. By 2000, the accumulated value of M&A deals in the Philippines was larger than the value accumulated in some of its peer economies, such as Indonesia, Thailand and Malaysia (Table 1.10).

In volume terms, it was only third, but the number of deals was not too different from the number of deals in the leading country, Malaysia. But since then, policy reforms in other Asian countries and their better – until recently – economic performance have allowed them consistently to outperform the Philippines in the attraction of FDI, at least in terms of cross-border M&A activity. Growth in both value and volume has been considerably lower in the Philippines than in these economies. While the number of deals increased 2.3 times from 2000 to mid-2015 in the Philippines, it increased over 3 to 5 times in the other selected countries, with often an even larger difference in value terms.

Table 1.10. **Cross-border M&A into selected ASEAN economies, 1990-2015**

	1990-2000		1990-2015		Growth	
Target Nation	Ranking value inc. net debt of target (USD m.)	Number of Deals	Ranking value inc. net debt of target (USD m.)	Number of Deals	Ranking value inc. net debt of target (USD m.)	Number of Deals
Philippines	12 079	274	33 171	640	2.7	2.3
Thailand	11 332	338	36 007	1 044	3.2	3.1
Indonesia	6 201	261	64 952	1 370	10.5	5.2
Malaysia	6 118	347	45 978	1 410	7.5	4.1

Notes: Data refers to cross-border deals completed until 31/07/2015. Only completed deals where the ultimate acquirer is not from the Philippines and where the acquirer's share ownership in the target company after the transaction is above 10% are included. This threshold is used as a proxy for FDI, since it denotes a lasting interest in the target company as defined in the OECD Benchmark Definition of Foreign Direct Investment (OECD 2009).

Source: Thomson Reuters One database.

Data on inward cross-border M&A also show a change in the sources of FDI over time. Japanese investors are now the leading investors through M&A in the Philippines, moving from the 5th largest investor in the 1990s to the first by mid-2015 (Table 1.11). As with FDI and approvals data, US investors are also major investors in terms of M&As, ranking second over the entire period or first in terms of the number of deals.

Table 1.11. **Cross-border M&As into the Philippines, country of origin, 1990-2015**

Acquirer ultimate parent nation	Ranking value inc. net debt of target (USD m.)	Acquirer ultimate parent nation	Deals (number)
Japan	8 386	United States	140
United States	5 431	Singapore	77
Hong Kong, China	3 451	Japan	73
Australia	3 056	Malaysia	57
United Kingdom	2 829	Hong Kong, China	54
Singapore	2 415	United Kingdom	44
Mexico	1 287	Australia	37
Switzerland	1 107	Thailand	24
Malaysia	1 101	Canada	23
Korea	1 034	France	16
Other	3 073	Other	95
Total	**33 171**	**Total**	**640**

Notes: Data refers to cross-border deals completed until 31/07/2015. Only completed deals where the ultimate acquirer is not from the Philippines and where the acquirer's share ownership in the target company after the transaction is above 10% are included. This threshold is used as a proxy for FDI, since it denotes a lasting interest in the target company as defined in OECD (2008).

Source: Thomson Reuters One database.

Among ASEAN economies, Singapore and Malaysia were the main sources of cross-border M&As in the 1990s, with Thailand becoming more important since 2000, while the number and value of deals involving Malaysian investors has decreased over time. Thai investors have been particularly directed towards the power, oil & gas and construction materials industries. In the 1990s, cross-border M&A from Malaysia were mainly directed towards the real estate and financial sector, whereas from 2000 onwards investments were more diversified towards energy and power, telecommunications and technology industries. Taken together, ASEAN investors have been the most prominent investors in recent years. From 2010 to mid-2015, they were responsible for 23% of the cross-border M&A deals in the Philippines, followed by investors from the United States (17%) and Japan (15%).

The sectoral distribution of cross-border M&A reflects the fact that they are mainly driven by investors wishing to access the domestic market and ample natural resources (Table 1.12). While the economy has also attracted some export-oriented investments, these have been relatively minor in comparison to investments in sectors such as food & beverage, metals & mining, power and alternative energy, and oil & gas, telecommunications and other infrastructure sectors. Professional services, which correspond essentially to business processing outsourcing and related services, also appear as a leading industry of cross-border M&A in the Philippines, most notably in term of the number of deals, but also in value although relatively less than in other sectors. Cross-border M&A activity in the sector has taken off since the mid-2000s, coinciding with the development or completion of IT business parks in the period and has continued to increase since the global financial crisis (Remulla and Medina, 2012). Investors from the United States were the most active in the sector. The Philippines also saw a number of cross-border M&A deals take place in the financial sector in the late 1990s and mid-2000s by investors based in Japan; Hong Kong, China; Singapore; the United States and a few European countries. The increased presence of foreign investors in the banking sector followed from major banking reforms implemented in the latter half of the 1990s.

Table 1.12. **Cross-border M&As into the Philippines, target industry, 1990-2015** [1, 2]

Ranking value incl. net debt of target (USD million)[3]		Number of deals[2]	
Food and Beverage	8 477	Metals & Mining	63
Power	6 528	Food and Beverage	46
Telecommunications Services	3 393	Banks	41
Metals & Mining	2 002	Other Financials	37
Alternative Energy Sources	1 690	Oil & Gas	32
Banks	1 534	Power	29
Oil & Gas	1 356	Insurance	29
Transport & Infrastructure	1 093	Chemicals	26
Other Financials	1 021	Transport & Infrastructure	24
Petrochemicals	694	IT Consulting & Services	21
Other	5 377	Other	292
Total	**33 170**	**Total**	**640**

1. Data refers to cross-border deals completed before 31/07/2015. Only completed deals where the ultimate acquirer is not from the Philippines and where its share ownership in the target company after the transaction is above 10% are included. This threshold is used as a proxy for FDI, since it denotes a lasting interest in the target company as defined in the OECD Benchmark Definition of Foreign Direct Investment (2008).

2. Thomson Reuters proprietary mid-level industry classifications based on SIC Codes, NAIC Codes and overall company business description. There are more than 85 mid-level industry classifications grouped by 14 macro-level categories.

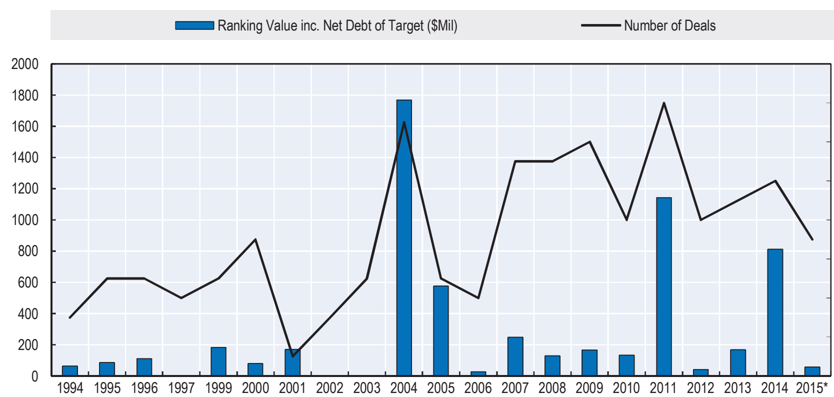
3. Ranking value including net debt of target refers to the amount paid by the acquirer for the target, including net debt, calculated as target short-term and long-term debt plus preferred equity minus cash on the balance sheet and marketable securities. Transaction values are available for only 361 out of 640 deals. The number of deals reflected in the chart includes those for which information on the transaction value is not available.

Source: Thomson Reuters One database.

Acquisitions by Philippine investors abroad

The Philippines has also become an increasing source of outward FDI in recent years, as was shown in Figure 1.10. The same trend can be seen in the M&A data (Figure 1.13), as a few Philippines-based companies have begun to look more actively for diversification opportunities outside the country. While there have been a few large outflow deals, the trend is more noticeable when one looks at the number of outward cross-border M&A deals by Philippine investors. Lower middle income countries, such as the Philippines, are not usually expected to have significant outward FDI, as there are usually ample opportunities for high private and social return from investments at home. In the Philippines, however, the level of outward FDI has increased considerably in recent years, surpassing the level of inward FDI in some years and making the country one of the few net outward investors in the region, along with Malaysia and Thailand.

Figure 1.13. **Cross-border M&A from the Philippines, 1990-2015**



Notes: * Data refers to cross-border deals completed before 31/07/2015. Only completed deals where the foreign acquirer's resulting share in the target company exceeds 10% are included. This threshold is used as a proxy for FDI, since it denotes a lasting interest in the target company as defined in OECD (2008); The database covers 152 deals, but transaction values are only available for 92 deals. The number of deals reflected in the chart includes those deals for which information on the transaction value is not available.

Source: OECD calculations based on Thomson Reuters One database.

StatLink http://dx.doi.org/10.1787/888933345035

Much of this outward M&A has occurred in the food & beverage, oil & gas, metals & mining industries (Table 1.13). Service sector investors have also increased their foreign presence by acquiring assets abroad, including in competitor markets such as India, a strong competitor in the BPO and IT services industries. In terms of destination markets, neighbouring ASEAN countries, notably Malaysia and Singapore, and other countries in the region, such as Hong Kong, China; and China, naturally play an important role, but overall outward acquisitions by Philippines firms have been quite diverse, including such developed markets as Australia, the United States and United Kingdom.

Table 1.13. **Cross-border M&A by Philippine firms by destination, 1990-2015**

Target economy	Value, incl. net debt of target (USD m.)	Deals (number)	Target mid industry	Value incl. net debt of target (USD m.)	Deals (number)
Australia	1 866	12	Food & beverage	2 751	16
Malaysia	679	10	Oil & Gas	722	13
Singapore	656	11	Metals & mining	509	13
New Zealand	608	1	Electronics	399	3
Hong Kong, China	458	14	Transport & infrastructure	330	16
UK	401	17	Non-residential	212	3
US	395	22	REITs	183	1
China	179	7	Other financials	161	12
Brazil	169	1	Food & beverage retailing	144	9
Mexico	148	4	Automotive retailing	97	2
Other	413	53	Other	463	64
Total	**5 971**	**152**	**Total**	**5 971**	**152**
ASEAN	1 480	34	Professional services and IT-related industries	57	22
ASEAN share	25%	22%	Professional services & IT-related industries share	1%	14%

Notes: Data refers to cross-border deals completed before 31/07/2015. Only includes completed deals where the immediate acquirer is Philippine and the target company is not, and where the acquirer's share ownership in the target company after the transaction is above 10%. This threshold is used as a proxy for FDI, since it denotes a lasting interest in the target company as defined in OECD (2008). The value is calculated as the amount paid by the acquirer for the target, including net debt, calculated as target short-term and long-term debt plus preferred equity minus cash on the balance sheet and marketable securities. The database covers 152 deals, but transaction values are only available for 92 deals. The number of deals reflected in the table includes those for which information on the transaction value is not available.

Source: Thomson Reuters One database.

Key reforms of the restrictions covering foreign direct investment

The Philippines started to open up in the late 1960s with the promotion of exports and FDI through the *Investment Incentives Act* (1967) and *Foreign Business Regulations Act* (1968), but de facto implementation was limited as local manufacturers continued to be protected. Foreign direct investment as a whole remained constrained by laws limiting foreign ownership of land, natural resources, public utilities, retail trade and other sectors, despite the partial liberalisation of the financial sector that resulted in some foreign participation.

From the gradual lifting of restrictions on foreign exchange transactions in the 1960s, the central bank introduced a wide range of reforms in the 1990s, including the removal of the mandatory surrender requirements for residents' foreign exchange receipts,[9] Further reforms were also introduced beginning in 2007, including eight waves of reforms covering current and capital transactions.

Restrictions for foreign investors were stipulated in the 1967 *Investment Incentives Act* (RA 5186) which also prescribed incentives and guarantees and created the BOI to carry out its provisions. Investments in pioneer industries[10] could be fully foreign-owned while investments in non-pioneer industries were restricted up to 40%. The ownership requirement was relaxed if the enterprise proposed to engage in a pioneer activity or if it exported at least 70% of its production. This was followed by the 1968 *Foreign Business Regulations Act* (RA 5455) which regulated foreign investment with equity participation exceeding 30% in enterprises that were not registered under the *Investment Incentives Act*. Foreign equity participation in enterprises that exceeded 30% required authorisation from the BOI, while those below 30% only had a registration requirement. The *Export Processing Zone Act* of 1972 permitted foreign ownership up to 100% but only for promoted industries, subject to the approval of the Export Processing Zone Authority, the government agency mandated to implement the Act and help promote investment in export-oriented manufacturing.

In 1987, the *Omnibus Investment Code* (EO 226) simplified and consolidated previous investment laws and added two new measures: income tax holidays for enterprises engaged in preferred areas of investment and labour expense allowances for tax deduction purposes. It also offered foreign and domestic investors fiscal and non-fiscal incentives provided they invest in preferred areas of investment identified annually in the Investment Priorities Plan (IPP). If the areas of investment are not listed in the IPP, they may still be entitled to incentives, provided: (*i*) at least 50% of production is for exports, for Filipino-owned enterprises; and (*ii*) at least 70% of its total production is for export, for foreign-owned enterprises.

The policy direction of the Philippines toward FDI changed in the 1990s, primarily for two reasons. The first was the decline in commercial bank loans and foreign aid in the 1980s after the debt crisis and the need to rely more on FDI for sustainable economic growth. The second was the widespread acknowledgement of the need to pursue export expansion and to capitalise on the potential economic contribution of FDI through knowledge and capital transfers. The FDI liberalisation process was accelerated through the *Foreign Investment Act* (RA 7042) in June 1991.This policy shift was complementary to other adopted market-oriented reforms consisting of trade liberalisation, privatisation, and economic deregulation in the 1980s and 1990s.

The *Foreign Investment Act* liberalised some existing regulations by allowing foreign equity participation up to 100% in all areas not specified in the Foreign Investment Negative List (FINL). The negative list originally consisted of three components: Lists A, B and C.

- **List A:** Areas where foreign ownership is limited by mandate of the constitution and specific sectoral legislation: mass media, practice of licensed professions, small-scale mining, private security agencies, and the manufacture of firecrackers and pyrotechnic devices. Foreign ownership ceilings are imposed on enterprises such as lending companies, advertising, domestic air transport, public utilities, pawnshop operations, education, employee recruitment, public works construction and repair (except Build-Operate-Transfer and foreign-funded or assisted projects), and commercial deep sea fishing.

- **List B:** Areas reserved for Filipino nationals for reasons of security, defence, risk to health and morals and protection of small and medium enterprises.

- **List C:** Areas in which there already exists an adequate number of establishments to serve the needs of the economy and further foreign investments are no longer necessary. This list has been abolished.

Prior to this, 100% eligibility for foreign investment was subject to the approval of the Board of Investments. The FINL was expected to provide transparency by disclosing in advance the areas where foreign investment was either allowed or restricted. It also reduced the bureaucratic discretion arising from the need to obtain prior government approval whenever foreign participation exceeded 40%. Over time, the negative list has been reduced. In March 1996, RA 7042 was amended through RA 8179 which further liberalised foreign investments, allowing greater foreign participation in areas that were previously restricted and abolishing List C. Table 1.14 provides a chronology of FDI liberalisation measures in the Philippines.

Table 1.14. **Foreign direct investment related liberalisation measures**

Year	Legislation	Description
1991	Foreign Investment Act [RA 7042]	Liberalised existing regulations & allowed foreign equity participation up to 100% in all areas not in the Foreign Investment Negative List (FINL) The FINL outlined all sectors where FDI was restricted Prior to this, 100% eligibility for foreign investment was subject to the approval of the Board of Investments
1993	Investors' Lease Act [RA 7652]	Any foreign investor investing in the Philippines shall be allowed to lease private lands in accordance with the laws of the Republic of the Philippines subject to the following conditions: (1) No lease contract shall be for a period exceeding 50 years, renewable once for a period of not more than 25 years; (2) The leased area shall be used solely for the purpose of the investment upon the mutual agreement of the parties; (3) The leased premises shall comprise such area as may reasonably be required for the purpose of the investment subject however to the Comprehensive Agrarian Reform Law and the Local Government Code. In addition to the conditions for the renewal of a lease agreement after the period of 50 years as provided herein, the foreign lease shall show that it has made social and economic contributions to the country. In the case of tourism projects, lease of private lands by foreign investors qualified herein shall be limited to projects with an investment of not less than USD 5 million, 70% of which shall be infused in said project within three years from the signing of the lease contract.
1994	Foreign Bank Liberalisation [RA 7721]	Allows the entry of additional foreign banks to operate in the Philippines and allows a foreign bank to acquire up to a 60% interest in an existing domestic bank. • BSP Circular No. 21 dated October 14, 1994 provided the implementing rules and regulations. RA7721 allowed the entry of foreign banks through one of the following methods. First, ten new foreign banks were allowed into the Philippines with each given full banking authority and the rights for up to six branches. Second, an unrestricted number of foreign banks were allowed up to a 60% ownership stake in any new Philippine banking subsidiary. Third, an unrestricted number of foreign banks were allowed to acquire, purchase, or own up to a 60% of an existing bank. This Act amended the General Banking Act of 1948, which had previously been amended by RA 337 which had limited the number of foreign banks operating in the Philippines to four.
1995	Water Crisis Act [RA 8041]	Privatisation and liberalisation of the Manila Water Sewerage System

Table 1.14. **Foreign direct investment related liberalisation measures** (cont.)

1996	Foreign Investment Act Amendment [RA 8179]	Amendment to the 1991 Foreign Investment Act [RA 7042] which further liberalised foreign investments and allowed greater foreign participation in areas that were previously restricted. This abolished List C which limited foreign ownership in "adequately served" sectors.
1997	Republic Act No. 8366	Liberalised the investment house industry where mandatory local equity participation was reduced from majority to 40% of the voting stock.
1998	Downstream Oil Industry Deregulation Act [RA 8479]	Deregulated the downstream oil industry to foster a truly competitive market which can better achieve the social policy objectives of fair prices and adequate, continuous supply of environmentally-clean and high-quality petroleum products.
2000	General Banking Law [RA 8791]	Allowed foreign banks to own up to 100% of one locally incorporated commercial or thrift bank during a 7-year window (with no obligation to divest later). To develop international financial centre operations in the Philippines and facilitate the flow of international capital into the country, foreign banks have been allowed to establish offshore banking units. Incentives have also been offered to multinationals that 16 establish regional headquarters or a regional operating headquarters in the Philippines, both of which are entitled to the following incentives: exemption from all taxes, fees, or charges imposed by a local government unit except real property tax on land improvements and equipment; tax and duty free imports of training materials and equipment; and direct imports of new motor vehicles, subject to the payment of the corresponding taxes and duties.
2000	Enabling Private Sector Participation in Energy [EO 232]	Department of Energy (DOE), shall engage in the assessment, field verification, harnessing, development and utilisation of ocean, solar and wind energy resources through the participation of the private sector under production sharing contracts awarded by the Secretary of the DOE
2000	Retail Trade Liberalisation Act [RA 8762]	Foreign-owned retailers may invest provided that they have a minimum paid-up capital of USD 2.5 million and comply with pre-qualification requirements.
2014	An Act Allowing for the Full Entry of Foreign Banks in the Philippines [RA 10641]	Amends RA 7721 (1994) which fully liberalises the sector, allowing foreigners to own up to 100% of domestic banks and facilitating the entry of established, reputable and financially sound foreign banks in the Philippines. It also grants locally-incorporated subsidiaries of foreign bank the same banking privileges as domestic banks of the same category.
2014	Cabotage Liberalisation Act [RA 10668]	Allows foreign vessels to transport and co-load foreign cargoes for domestic transhipment and for other purposes

In response, many different stakeholders from the government, private sector and civil society argue for the liberalisation of protectionist clauses contained in the 1987 Constitution and the elimination of the Negative List which many see as restricting the flow of FDI in the country. Despite the sectoral liberalisation efforts that have improved the investment climate, the Constitution restricts foreign ownership of property to 40% (Article XII), with minor adjustments and deviations in subsequent legislation. Removing the clause, and improving access and protections of foreign-owned business, would facilitate a potentially significant increase in FDI.

Box 1.2. **Amending the economic provisions of the 1987 Constitution**

In formulating the 1987 Constitution, the integration of economic policies was one of the most widely debated topics, along with the abolition of capital punishment, the continued retention of American military bases and the form of government to adopt. The 1987 Constitution contains many strong restrictions targeted against the flow of foreign capital in specific economic activities. These restrictions were the same ones that were incorporated into the nationalistic provisions of the 1935 Constitution when its framers were anticipating future political independence. Restrictions include limits to foreign equity in the exploration, development, and use of natural resources; public utilities; build-operate-transfer projects; operation of deep-sea commercial vessels; and others. The 1987 Constitution also prohibits foreigners from owning land and equity in mass media and the practice of professions.

Constitutional reform in the Philippines or Charter Change refers to the political and legal processes required to amend the Constitution of the Philippines. The current constitution, the 1987 Constitution states that amendments can be proposed by one of three methods:

1. People's Initiative: Shall only be valid when ratified by the majority of Filipinos in a plebiscite
2. Constituent Assembly: A Constituent assembly is composed of all members of Congress (Senate and House of Representatives). It is convened by Congress to propose amendments to the 1987 constitution. Under Article XVII of the Constitution, amendments pass upon a vote of three-fourths of all members of Congress, but it is not clear if the Congress should vote as a single body or as separate Houses. Convening Congress as a Constituent Assembly is not explicitly provided for in the Constitution.

Constitutional Convention: The Congress may, by a vote of two-thirds of all its Members, call a constitutional convention, or by a majority vote of all its Members, submit to the electorate the question of calling such a convention

The proposed amendments would then have to be ratified by a majority vote in a national referendum. While no amendment to the 1987 Constitution has succeeded, there have been several high-profile attempts but none has reached the ratification stage.

Source: Aldaba et al. (2012).

According to Tacujan (2013), "By imposing restrictions on foreign ownership, charter Philippine lawmakers believed they protected the country's sovereignty from foreign encroachments. The thought was that by imposing barriers on foreign trade and investments and prohibiting controlling property rights of foreign nationals, domestic economic strength and independence would be achieved." The 1987 Constitution, created to replace the 1973 Constitution that provided constitutional justification to the autocratic rule of former President Marcos who was seen to have been close to foreign interests, was drafted under a tense political atmosphere of transition. "Interest groups, including industry groups and leftist academics, took advantage of this public sentiment during the constitutional drafting process."

The Philippines in the OECD FDI Regulatory Restrictiveness Index

A country's investment climate cannot be captured in a single indicator, whether on the costs of doing business or a measure of statutory restrictions on FDI. Many different policies and practices impinge on investment decisions, and the way – and whether – policies are implemented is arguably as important as the policies themselves. Quantitative indicators have nevertheless proven highly effective in drawing attention to the burdens of business regulation, identifying priorities for reform and communicating success and progress.

The OECD *FDI Regulatory Restrictiveness Index* (*FDI Index*) seeks to gauge the restrictiveness of a country's FDI rules and is currently available for almost 65 countries (Box 1.3). The *FDI Index* does not provide a full measure of a country's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of a country's attractiveness to foreign investors and the *FDI Index*, used in combination with other indicators measuring various aspects of the FDI climate, contributes to assessing countries' international investment policies and to explaining variations among countries in attracting FDI.

According to the *FDI Index* (Figure 1.14), the Philippines' FDI regime is one of the most restrictive, compared to OECD and non-OECD countries. Most of the FDI restrictions are in the form of equity restrictions stemming from the foreign ownership limitation of 40% across multiple sectors. On a sectoral level, Figure 1.15 illustrates the level of equity restrictions by sector for the Philippines.

Box 1.3. **Calculating the OECD FDI Regulatory Restrictiveness Index**

The OECD *FDI Regulatory Restrictiveness Index* covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transport, construction, distribution, communications, real estate, financial and professional services).

For each sector, the scoring is based on the following elements:

- the level of foreign equity ownership permitted,
- the screening and approval procedures applied to inward foreign direct investment;
- restrictions on key foreign personnel; and
- other restrictions such as on land ownership, corporate organisation (*e.g.* branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is a weighted average of individual sectoral scores.

The measures taken into account by the index are limited to statutory regulatory restrictions on FDI, typically listed in countries' lists of reservations under FTAs or, for OECD countries, under the list of exceptions to national treatment. The *FDI Index* does not assess actual enforcement and implementation procedures. The discriminatory nature of measures, i.e. when they apply to foreign investors only, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. Preferential treatment for special-economic zones and export-oriented investors is also not factored into the FDI Index score.

For the latest scores and more on the methodology, see *www.oecd.org/investment/index.*

Restrictions on FDI tend to arise in the same sectors across countries: media, air transport, fisheries, etc. The Philippines has a high level of statutory restrictions, as measured by the *FDI Index*, across many sectors, with the exception of manufacturing, financial services and to some extent distribution. Services sub-sectors such as business services, media, telecommunications and transport are quite restrictive especially when compared to the OECD average. Restrictions include the following:

- **Public utilities (telecommunications, electricity, transport) -** No franchise, certificate, or any other form of authorisation for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organised under the laws of the Philippines, at least 60% of whose capital is owned by such citizens. (Article XII (11) of the 1987 Constitution). Furthermore, on the senior management and board of directors of public utilities, the provisions of *Commonwealth Act* No. 108 or Anti-Dummy Law, govern: the election of aliens as members of the board of directors or governing body of corporations or associations engaging in partially nationalised activities shall be allowed in proportion to their allowable participation or share in the capital of such entities.

- **Retail** – through the *Retail Trade Liberalisation Act* of 2000 (RA 8762), 100% foreign equity is allowed provided that the foreign retailer has a minimum paid-up capital of the equivalent in Philippine pesos of USD 2.5 million.
- **Land** - All lands of the public domain are owned by the State. Ownership and lease of public agricultural lands is limited to Filipino citizens and natural-born citizens of the Philippines and corporations or partnerships at least 60% of the capital of which is owned by Filipinos. (Article XII (2) of the 1987 Constitution). However, any foreigner investing in the Philippines shall be allowed to lease private land for a period not exceeding 50 years, renewable once for a period of not more than 25 years, under the *Investors Lease Act* (RA 7652).

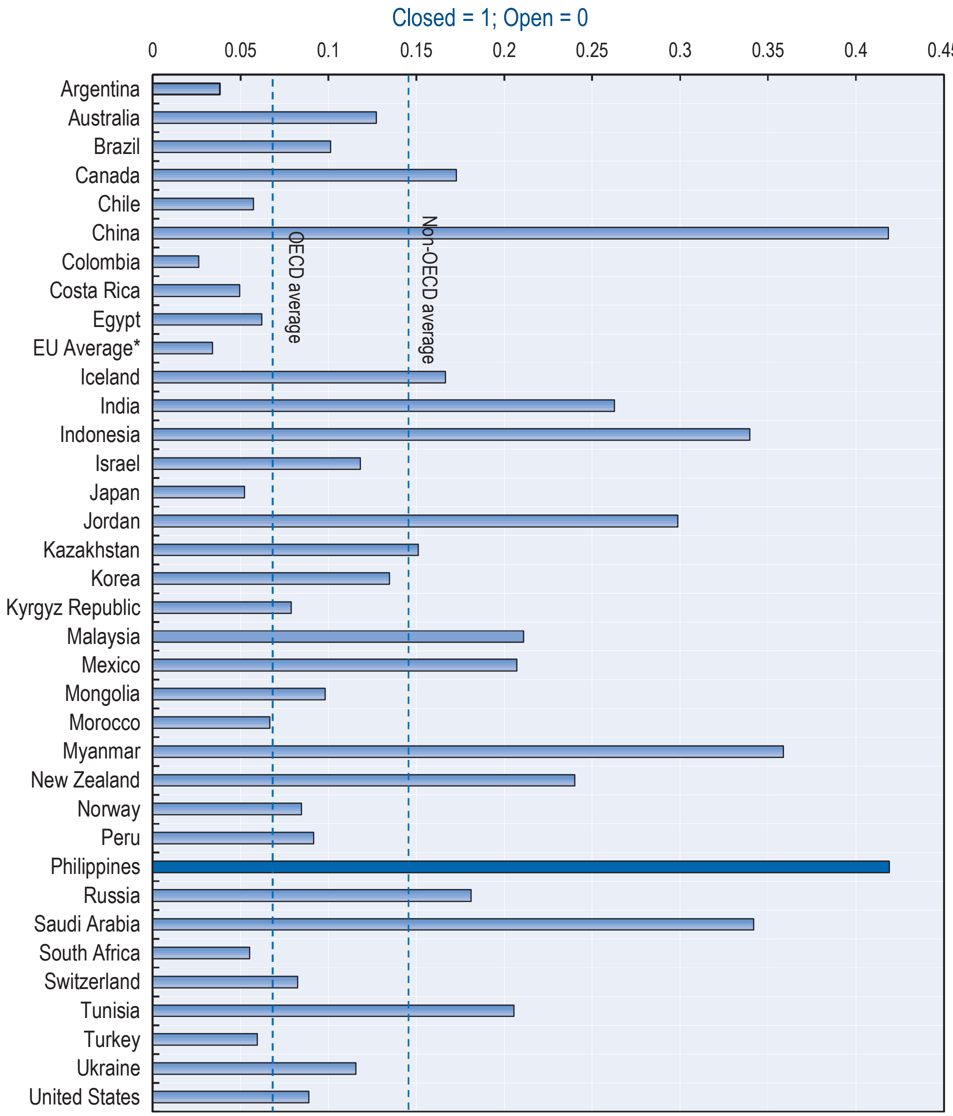
The list of equity restrictions contained in the Negative List state the following.

Table 1.15. **Tenth Foreign Investment Negative List: Equity restrictions by sector**

Sector	Sub-sector	Equity Restrictions Changes
Agriculture		40%
Business services	Accounting & audit	No foreign equity
	Architectural	No foreign equity
	Engineering	No foreign equity
	Legal	No foreign equity
Construction		25% for construction and repair of locally-funded public works; 25% for contracts for the construction of defence-related structures
Electricity	Distribution	30%-40%
	Generation	30%-40%
Fisheries		30%-40%
Forestry		30%-40%
Media	Broadcast	No foreign equity except for private radio networks (20%)
	Other media	Advertising (30%)
Real estate		40% for private land
Telecoms	Fixed telecoms	30%-40%
	Mobile telecoms	30%-40%
Transport	Air	40%
	Maritime	40%
	Surface	40%

Source: 10th Philippines Foreign Investment Negative List (FINL).

Figure 1.14. **OECD FDI Regulatory Restrictiveness Index, 2014**



Source: OECD FDI Regulatory Restrictiveness database.

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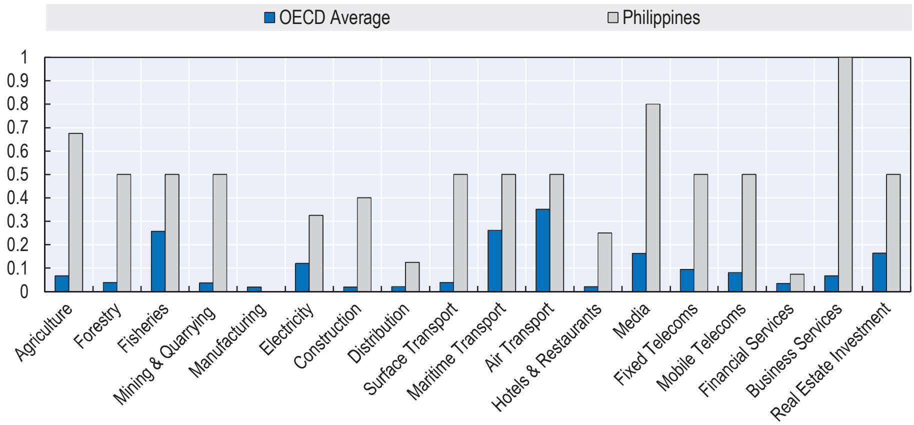
Figure 1.15. **OECD FDI Index, 2014, equity restrictions by sector**



Source: OECD FDI Regulatory Restrictiveness database.

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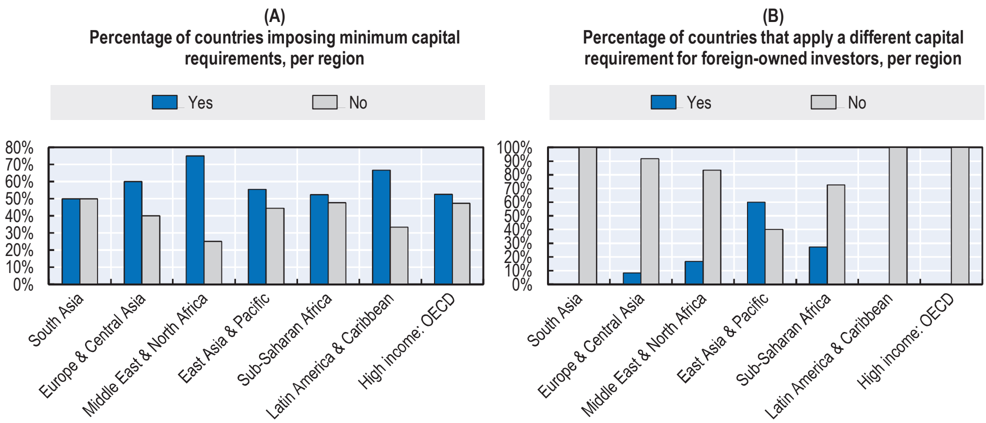
Minimum capital requirements

Another restriction on foreign investment concerns a minimum capital requirement which is higher than in many other countries. The use of minimum capital requirements by countries has declined considerably over the past decade. According to the World Bank (2014b), 39 economies eliminated capital requirements in the past seven years, and many others never had them in the first place. Despite this, minimum capital requirements remain a reality in many countries. Out of the 189 economies included in the *Doing Business* indicators (World Bank 2015), 72 economies (roughly 38%) still apply minimum capital requirements. Across regions, minimum capital requirements, as a percentage of income per capita, are the highest in Africa, although the amount required has been reduced over time.

If the application of minimum capital requirements is becoming rarer, the discriminatory application of such mechanisms between foreign and domestically-owned companies diverges even further from international practice. The Philippines is among the few countries in the world that discriminates between domestic and foreign investors in the application of minimum capital requirements. Under the RA 7042, as amended by RA 8179, also known as the *Foreign Investment Act*, foreign-owned companies are subject to a minimum paid-up capital requirement of USD 200 000. The amount may be reduced to USD 100 000 if the project involves advanced technology, as determined by the government, or directly employs at least 50 Filipinos. Foreign-owned companies exporting 60% or more of their output or domestic purchases are exempted from the requirement.

According to the World Bank's *Investing Across Borders* database, only eight countries of the 104 economies covered in the database discriminate against foreign investors in imposing minimum capital requirements (Figure 1.16).

Figure 1.16. **Discriminatory minimum capital requirements by region**



(A) data refers to a sample of 95 countries (6 countries in South Asia; 20 in Europe & Central Asia; 8 in the Middle East & North Africa; 9 in East Asia & Pacific; 21 in Sub-Saharan Africa; 12 in Latin America & the Caribbean; and 19 in High income: OECD). In total, 55 countries apply minimum capital requirements;

(B) data refers to a sample of 55 countries that apply (3 countries in South Asia; 12 in Europe & Central Asia; 6 in the Middle East & North Africa; 5 in East Asia & Pacific; 11 in Sub-Saharan Africa; 8 in Latin America & the Caribbean; and 10 in High income: OECD). In total, only 8 countries discriminate in the application of minimum capital requirements between foreign and domestic investors.

Source: World Bank's Investing Across Borders database.

StatLink http://dx.doi.org/10.1787/888933345067

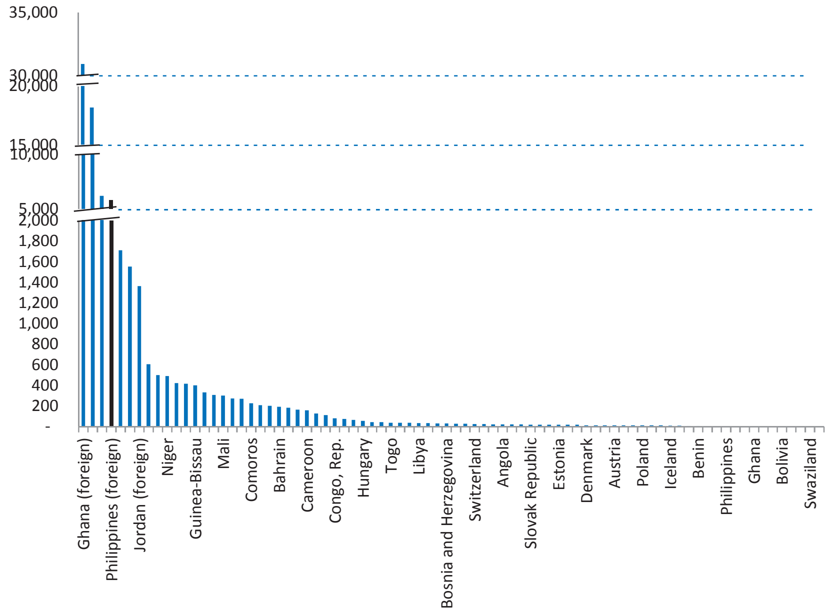
Furthermore, the minimum capital of USD 200 000 required from foreign investors in the Philippines is substantially greater than capital requirements for both domestic and foreign investors in OECD countries and large developing economies, such as China, Indonesia, India and Russia (Figure 1.17). The Philippines clearly stands out as an outlier in this respect, including compared to countries with similar income per capita levels.

The measure affects most the non-capital intensive industries, such as services, and particularly foreign small and medium companies (SMEs). Small entrepreneurial companies are common in many service-sectors, including more knowledge-intensive activities, and the imposed minimum capital requirement can potentially lead foreign SMEs to forgo certain investment opportunities or decide to locate elsewhere. In sectors where barriers to entry are relatively low and investors and labour are largely mobile, measures increasing the cost of doing business affect directly the country's competitiveness in the sector.

The early rationale for countries to adopt minimum capital requirements was to protect consumers and creditors from risky and potentially insolvent business. By requiring investors to lock-in upfront a minimum amount of capital, investors were expected to be more cautious about undertaking commercial opportunities. But evidence points to a limited effectiveness at best in this regard, with some notable exceptions such for financial services (*e.g.* banking and insurance). Minimum paid-in capital requirements, as often stipulated by the commercial code or company law, rarely take into account firms' differences in economic activities, sizes or risks, thereby offering only a limited recourse to address businesses' different probabilities of default. Funds tied up for such purposes could be used in other critical activities for a company's sustainable growth and solvency. Creditors also prefer to rely on objective assessments of a company's commercial risks based on analysis of its financial statements, business plans and business references etc., instead of legally-imposed capital requirements, as many other factors can affect a firms' possibility of facing insolvency. Moreover, minimum capital requirements are particularly inefficient if firms are allowed to withdraw deposited funds soon after incorporation (World Bank, 2014b). In this situation, they act merely as barriers to entrepreneurship, particularly to SMEs.

The empirical literature suggests a number of shortcomings of minimum capital requirements, notably to the detriment of entrepreneurial activity and companies' growth. As the World Bank (2014b) highlights, contrary to governments' expectations, evidence suggests that minimum capital requirements may not help countries recover their investments as they are negatively associated with creditor recovery rates: credit recovery rates tend to be higher in economies without minimum capital requirements, which suggest that other alternative measures (e.g. efficient credit and collateral registries and enhanced corporate governance standards) are potentially more efficient in addressing such concerns. Moreover, minimum capital requirements have been found to be associated with lower access to finance for small and medium-size enterprises. Higher requirements are also associated with higher the levels of informality, as well as with longer number of years a firm operate without formal registration. They also tend to discourage formal entrepreneurial activity and diminish firms' growth potential.

Figure 1.17. **Minimum capital requirements for foreign investors by country, 2014**



Notes: The figure includes all countries covered by the Doing Business ranking that apply a minimum capital requirement to domestic enterprises, as well as the 8 countries covered in the Investing Across Borders database that apply a different minimum capital requirement for foreign-owned established enterprises. The data for the Philippines refer to the minimum capital requirement applied to domestic enterprises, and the data for the Philippines (foreign) refer to the level required from foreign-owned enterprises in the country. The minimum capital requirement refers to the level required for a wholly-owned, foreign-established company and does not take into account possible sectoral variations and other exemptions.

Source: World Bank World Development Indicators; World Bank's Doing Business Ranking 2015, World Bank's Investing Across Borders 2014.

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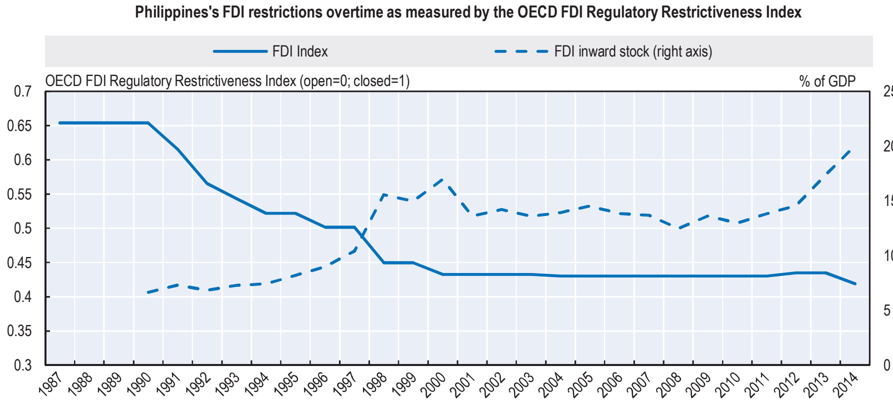
Liberalisation of FDI restrictions over time has had an impact on FDI inflows

As described earlier, FDI restrictions have nevertheless been reduced over time in certain sectors. Figures 1.18 and 1.19 show this liberalisation as measured by the *FDI Index*. Reforms were particularly prominent in the 1990s. Figure 1.17 illustrates the sharp increase in FDI inward stock in the late 1990s along with the liberalisation of certain services sectors in the country (e.g. power, telecommunications, banking and retail trade). Figure 1.19 illustrates the Philippines' investment liberalisation reform path compared to Indonesia and Malaysia.

Figure 1.18. **Philippine FDI restrictions are decreasing over time**



Source: OECD calculations based on OECD FDI Regulatory Restrictiveness Index database and UNCTAD for FDI stock as a share of GDP.

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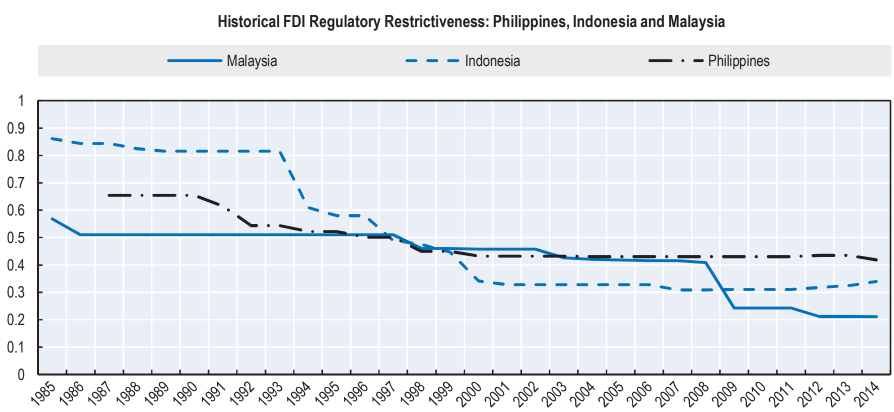
Figure 1.19. **Malaysia and Indonesia have liberalised more over time than the Philippines**

(FDI Regulatory Restrictiveness Index, 0=open; 1=closed)



Source: OECD calculations based on OECD FDI Regulatory Restrictiveness Index database.

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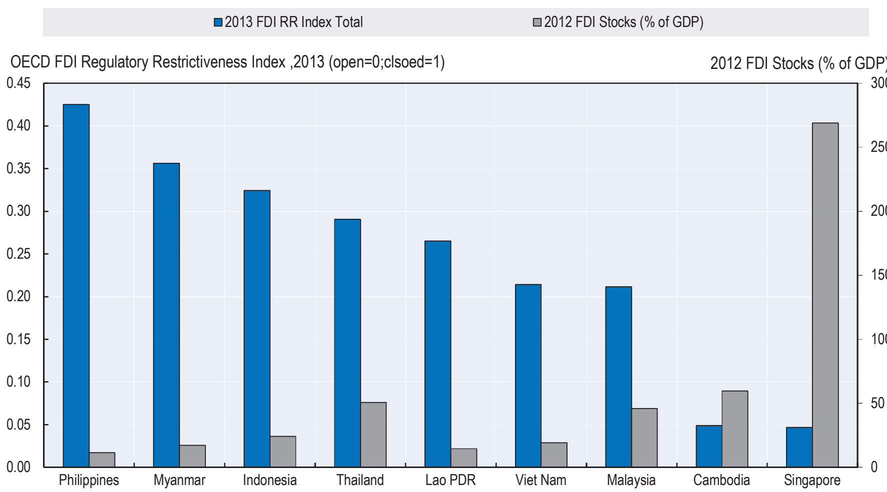
A key message from the *FDI Index* is that statutory restrictions matter for foreign investment, as the relationship between FDI restrictions and FDI stocks (normalised for market size) is highly negatively correlated, as seen in Figure 1.20. The two most restrictive countries (Philippines and Myanmar) have the lowest stock of FDI to GDP, even if one adjusts for the possibility of under-reporting of FDI in the Philippines. Similarly, the two most open economies for foreign investment in the region (Singapore and Cambodia) have the highest stocks of FDI relative to GDP. While this is only a simple correlation based on a small sample of countries, the same overall negative relationship between FDI restrictions and FDI stocks normalised by market size exists for the whole sample of 70 countries covered by the *FDI Index*.

Figure 1.20. **FDI Index scores vs FDI stocks as a share of GDP in ASEAN9 members**



Source: OECD (2014b).

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Why might foreign equity restrictions which are the most common restriction in most countries and sectors matter for investors? Multinational enterprises (MNEs) from the United States, for example, have a strong preference for majority ownership. Fully 94% of the foreign affiliates of US MNEs worldwide and 95% of affiliates in Southeast Asia are majority-owned. Having full control over affiliates allows MNEs to protect their intangible assets and proprietary technology, better control any reputational risks concerning labour practices and the environment, and minimise the risk of being involved in corruption cases for which they could be legally liable back home. Beyond these considerations, having full control may be preferable simply because it allows the MNE parent to avoid conflicts when its strategy for the affiliate diverges from that of the domestic partner. Having control may be even more important in markets where minority shareholders have only weak protection of their rights. Nonetheless, restrictions on foreign equity ownership may not affect all investors equally and may differ in their impact across sectors and depending on the home country of the investor.

FDI has helped the Philippines link to regional and global value chains

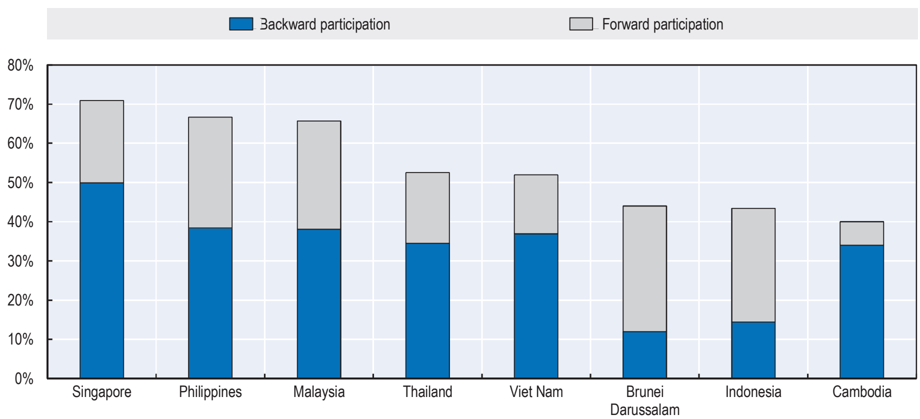
A closer look at the type of FDI that the Philippines has mainly received so far provides insights into the nature of its economic impact. Most FDI in the Philippines comes from vertically integrated multinational enterprises, with the Philippines serving as one of the parts of MNE production networks. In theory, participation in these types of regional/global production networks provides domestic firms not only with access to export markets but also to newer technologies which can generate substantial positive spillovers and externalities. This kind of FDI can be effective in supporting economic integration, fostering linkages with domestic firms, improving export competitiveness by exposing local firms to foreign technologies, and thereby increasing economic growth (World Bank 2014a).

Regional supply chains in Asia emerged in the 1980s as Japanese firms invested heavily in the region. Following the 1985 Plaza Accord, Japanese manufacturers relocated in East and Southeast Asia to establish lower cost production bases (OECD 1999). This began a trend of multinationals from other developed economies seeking labour and product cost reductions to invest and establish subsidiaries in the region to improve their competitiveness (Banga, 2013). International fragmentation of supply chains has allowed countries, particularly developing ones, to internalise some of the benefits of these fragmented production networks, including by facilitating the entry of small local firms into global markets as suppliers to established networks without requiring the costs of building the value chain themselves (Cattaneo et al., 2013).

The surge in manufacturing investment led to a shift in productive capacity within host countries in the region. Among ASEAN member states, Singapore, Malaysia and Thailand were early adopters of export strategies based on foreign investment, resulting in a rapid expansion of their manufacturing base. Indonesia and the Philippines followed suit, with both countries developing a more open policy to foreign investment in the 1990s.

The participation of ASEAN economies in global value chains can be characterised in two ways: as users of foreign inputs and as suppliers of intermediate goods and services in other economies' exports (Koopman et al., 2009). The *GVC Participation Index* indicates the share of foreign inputs in economies' exports (backward participation) and the share of domestically produced inputs used in third economies' exports (forward participation). Overall, it represents the extent of countries' presence in GVCs (Figure 1.21). Across ASEAN economies, the Philippines has the second highest level of GVC participation driven by their exports in the electronics and optical equipment sector. Looking at the ratio between its backward participation (38%) and forward participation (28%) suggests that the country has significantly increased its domestic value added embodied in exports but this has been accompanied by an important surge in the use of foreign value added.

Figure 1.21. **ASEAN-7 GVC Participation Index, 2009 (% of total exports)**



Source: OECD-WTO Trade in Value Added.

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As stated in the industry roadmaps, the government would like to further increase the Philippine participation, particularly in the electronics sector by upgrading to higher value added activities. FDI openness can help boost GVC participation. Even if the Philippine manufacturing sector is open, restrictions on services can affect the goods sector. Promoting more FDI in service sectors can contribute to economy-wide productivity gains and help strengthen the Philippine role in global value chains. To make the case for intra-industry linkages, restrictions in one sector might have implications for investment in other sectors and thus might impede investors across the board.

Restrictions on FDI in service sectors affect the overall competitiveness of other sectors and discourage investment in those sectors. An efficient and competitive services sector, particularly backbone services, will raise the performance of firms throughout the economy, including in the manufacturing sector. Manufacturing industries relying on these services as inputs would thereby benefit from the improved quality and lower cost of service inputs which would increase the marginal productivity of other inputs. A recent study by Duggan et al. (2013) employs the *FDI Index* to assess the effects of restrictions on FDI in services on the manufacturing productivity of Indonesian firms from 1997 to 2009. The study finds that service sector FDI liberalisation, notably related to equity limits and screening and prior approval requirements, accounted for 8% of the observed increase in Indonesian manufacturers' total factor productivity over the period.

Furthermore, as the offshoring experience of the Japanese manufacturing sector in the Philippines and other ASEAN countries suggests, multinational enterprises are the natural central unit behind GVCs and therefore their investment decisions have been a major driver behind the emergence of GVCs. UNCTAD (2013) estimates that MNEs account for about 80% of global trade in goods and services, of which about 42% is intra-firm trade. FDI is therefore an important avenue for countries to link to GVCs and increase their participation.

Figure 1.22. **FDI and GVC participation**

Source: OECD-WTO Trade in Value Added and UNCTAD FDI Statistics - May 2013.

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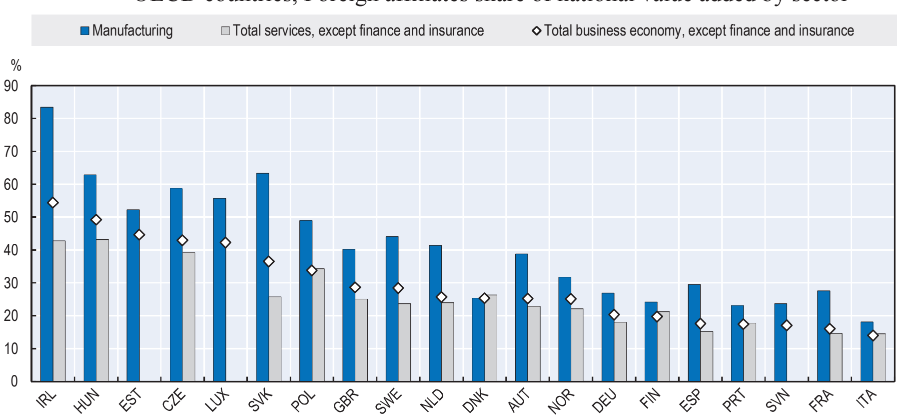
The extent to which countries can provide the necessary conditions for global production networks to operate efficiently is therefore a key determinant of their success in linking to GVCs. Multinational firms' locational decisions have become more influenced by their need to ensure predictable and reliable supply-chains, capable of delivering effectively on each stage of the chain (Taglioni and Winkler, 2014). The costs of delays can be substantial for certain product categories (a tariff equivalent of 1% or more) (Hummels, 2007).

In terms of overall competitiveness, foreign affiliates contribute to a host country in several ways. They can provide access to new markets and new technologies for domestic suppliers and buyers, generate knowledge spillovers for domestic firms and typically invest a higher share of revenues in R&D. Evidence from OECD countries shows that foreign controlled firms are few but account for a very large share of trade. Figure 1.23 illustrates the share of national value added under control of foreign affiliates for manufacturing and services. The share in value added of multinational enterprises is high partly due to the fact that they are typically engaged in capital- and scale-intensive industries. While in absolute terms, value added by foreign affiliates is larger in services than in manufacturing in several OECD countries, owing to the importance of services in national economies but also to the growing internationalisation of services.

Figure 1.23. **Share of national value added under control of foreign affiliates, 2010**

OECD countries, Foreign affiliates share of national value added by sector



Source: OECD, Activity of Multinational Enterprises Database, www.oecd.org/sti/ind/amne.htm; Eurostat, Inward FATS Database, June 2013.

StatLink http://dx.doi.org/10.1787/888933345135

FDI spillovers depend on the host country's domestic policies

The experience of the Philippines with FDI spillovers shows that these effects are not automatic. Participation in global value chains can assist development, but at the country level, constraints such as the supply of various types of labour and skills and inadequate absorptive capacity remain. Opening up the economy to FDI has contributed to exports of high-technology products and overall economic growth, but the spillover effects of FDI to domestic firms have remained limited due to their weak competitiveness and inability to absorb the technology or knowledge being transferred. For spillovers to take place, the absorptive capacity of domestic firms must be strengthened. Developing domestic parts suppliers would help to deepen the firm linkages within the economy (see Chapter 3).

The Philippine government has already emphasised the need to place micro, small and medium enterprises (MSMEs) at the front and centre of the regional trade agenda. As 99% of firms in the Philippines are MSMEs which employ more than 50% of the entire domestic workforce, a focus on SME development, financing and capacity building programmes is necessary. The APEC "Boracay Action Agenda to Globalise MSMEs" (APEC, 2015), an agreement among APEC members to bolster the ability of MSMEs to participate in cross-border business is one recent effort.

Another crucial issue is domestic market connectivity which is as important as international connectivity. For instance, the benefits of efficient transport and logistics at the border could be weakened by inefficient domestic links. The ease of access to efficient services and infrastructure, including inexpensive and reliable energy, finance, telecommunications and transport, are key decision points for foreign investors. These service sectors are likely to have the highest gains in terms of capital, technology and improved governance. Liberalising these sectors by allowing the entry of international operators increases the potential to maximise these gains along with the opportunity to generate jobs and increase real income.

Notes

1. The Philippine automotive industry developed under heavy government protection and regulation. After almost three decades of import substitution (from the 1970s to the 1990s) which was centred on local content policy, a large part of the parts and components industry still remains underdeveloped. With few backward linkages created, the link between the automotive assembly sector and local parts and components has remained weak. As such, the local content programme only had a limited impact on the growth and development of the parts and components industry. Very few parts and components are locally sourced with the domestic parts sector accounting for only 10-15% of the total number of parts and components needed by local assemblers. In contrast, the Thai auto industry sources close to 85-90% of their parts domestically. (Aldaba and Aldaba 2010).

2. World Bank (2013).

3. Based on data presented by former Economic Planning Minister, Cielito Habito in 2012.

4. International Labour Organization calculations.

5. Based on World Bank data.

6. Baclagon et al. (2004) and International Finance Corporation (2012).

7. To support industry consolidation, the BSP has also implemented a programme of tax incentives for larger stable banks to acquire weak rural banks (BBVA, 2015).

8. The Laurel–Langley Agreement (1955, expired 1974) provided US investors with access to all areas of the economy and allowed them full foreign ownership.

9. As embodied under Circular No. 1389 dated 13 April 1993, among others.

10. Pioneer projects are those which (i) engage in the manufacture, processing or production; and not merely in the assembly or packaging of goods, products, commodities or raw materials that have not been or are not being produced in the Philippines on a commercial scale; (ii) use a design, formula, scheme, method, process or system of production or transformation of any element, substance or raw materials into another raw material or finished goods which is new and untried in the Philippines; (iii) engage in the pursuit of agricultural, forestry, and mining activities considered as essential to the attainment of the national goal; and (iv) produce unconventional fuels or manufacture equipment which utilises non-conventional sources of energy. Non-pioneer projects include those that are engaged in common activities in the Philippines and do not make use of new technology.

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Annex 1.A1.

Sources and methodologies of Philippine FDI statistics

From the Philippine Statistics Authority:

The National Statistics Coordination Board (NSCB) is the agency responsible for coordinating all statistical matters and for managing the Foreign Investments Information System (FIIS). Launched in 1991, the FIIS project serves to be an integrated approach for generating and reporting foreign direct investments in the Philippines.

Statistics on FDI are reported and generated by a number of agencies that carry out functions relating to management, and monitoring and promotion of foreign investments in the country, which has often resulted in inconsistent data generation and interpretation because of differences in concepts, definitions and reporting periods adopted by the concerned agencies. With the objective of resolving this problem and other issues in the generation and reporting of foreign investment statistics, the NSCB created an ad hoc Inter-Agency Group in 1991 to conduct a study for the implementation of the FIIS. The Group published its first report of the FIIS Study in July 1996 which recommended a system that will operationalise the concepts and methodologies for developing and compiling foreign direct investment statistics in the Philippines context. The report featured the results of the 1991-1992 estimates of stock of FDI, and the concepts, methodology, data system and institutional support needed to implement the FIIS.

Based on the recommendation in the FIIS Study, the NSCB created the Inter-Agency Committee on Foreign Direct Investments Statistics in September 1996 to rationalise and integrate foreign investments data in all aspects including collection, processing and dissemination. The Committee is now composed of ten member agencies: National Statistical Coordination Board; Board of Investments (BOI); Bangko Sentral ng Pilipinas; Bureau of Trade Regulation & Consumer Protection; Clark Development Corporation; National Economic and Development Authority; National Statistics Office; Philippine Economic Zone Authority; Securities and Exchange

Commission; and the Subic Bay Metropolitan Authority. These member agencies of the FIIS jointly implement the institutionalisation of the FIIS.

Technical Notes: FDI from the Philippine Statistical Authority and BSP

Based on the International Monetary Fund's sixth edition of the Balance of Payments and Investment Position Manual (BPM6), direct investment is a category of cross border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is a resident in another economy. Operationally, direct investment in an enterprise is indicated by ownership of at least 10% of equity shares. Less than 10% ownership is considered as portfolio investments.

The compilation of the net incurrence of liabilities/FDI statistics, including data sources and methodologies used, conforms to the internationally accepted standards and guidelines set forth in the BPM6 and the standards prescribed in the IMF's Special Data Dissemination Standard.

In terms of classification, direct investments can be in the form of equity capital, reinvestment of earnings and debt instruments. Net equity capital is broken down by industry group based on the 2009 Philippine Standard Industrial. Net equity capital is also broken down by country of origin. No industry and no country breakdown are available for reinvestment of earnings and debt instruments in the absence of information. Since the Philippines is more of a recipient of foreign investments, the FIIS covers only inward foreign direct investments. Specifically, this includes foreign direct investments in Philippine corporations, partnerships and single proprietorships.

Foreign direct investment flows refer to the new or additional investments paid by a foreign entity to a resident enterprise in another country during the period. In the Philippines, this covers: capital or equity contributions/remittances from abroad, reinvested earnings, technical fees and royalties converted to equity, bonds and other debts converted to equity and imports converted to equity.

Approved foreign direct investments represent the amount of proposed contribution or share of foreigners to various projects in the country as approved and registered by the BOI, the PEZA, the SBMA, the CDC, the AFAB, the BOI-ARMM, and the CEZA. Approved foreign investments do not represent actual investments generated but rather foreign investment commitments which may come in the near future. This consists of equity, loans and reinvested earnings. In the operationalisation of computing for approved FDI as approved and registered with the Investment Promotion

Agencies (IPAs), all FDI including those with less than 10% of the ordinary shares are included. The reason is that approved FDI as rendered by the IPAs have long lasting interest unlike portfolio investments.

Approved FDI in the Information and communication technology sector (ICT) includes investment commitments in the manufacturing of ICT equipment, spare parts and accessories including professional, medical and scientific instruments as well as ICT services *e.g.* wholesale trade of computers, electronic parts and equipment; telecommunications; renting of computers and other office equipment; computer services and other related activities.

Registered FDI only represents foreign equity investments or paid up capital and does not include intercompany loans. Hence, not all approved FDIs are translated into registered FDIs since the former consist of intercompany loans and reinvested earnings. In addition, capital inflows from approved FDIs are spread or expected to be fully implemented after five years or more, based on the experience of investment promotion agencies. FDI in the balance of payments covers cash and non-cash transactions on foreign direct investment flows through the banking system. Machinery, equipment and reinvested earnings which are not cash transactions are included if data are available.

Chapter 2

Legal protection of investment in the Philippines

This chapter examines legal protection for domestic and foreign investors in the Philippine regulatory framework for investment. It looks at reforms that have progressively been introduced to enhance the transparency and predictability of investment policies, along with the progressive liberalisation of investment restrictions. Both domestic and foreign investors now benefit from key protection provisions under domestic law and international investment agreements. Particular attention is given to the regime for expropriation, as well as to the reform efforts made to protect intellectual property rights and to improve the access of foreign investors to land. The adjudication of investment disputes, including investor-state disputes, and Philippine investment treaty practice, including its relation with emerging ASEAN practice, are also addressed. The ongoing review of the existing investment treaties of the Philippines offers an opportunity for further modernising and harmonising Philippine investment policy.

Summary

Guarantees of property rights protection have progressively been introduced in the legislation governing investment. Both foreign and domestic investors now benefit from key protection provisions under domestic law. Foreign investors are allowed to hire both domestic and foreign employees and are granted rights of residence and free repatriation of capital. Both domestic and foreign investors are also provided with guarantees of legal stability and predictability of investment incentives, thus preserving policy flexibility to introduce changes to other aspects of the investment regime. Although the current regime is comprehensive, the existence of two separate laws governing investment (the *Omnibus Investment Code* and the *Foreign Investment Act*) might impede its readability.

The legislation governing land still restricts foreigners' rights to land. The current land titling and registration system does not allow the degree of security required to provide for well-defined and sufficiently secure ownership that would encourage new investment. The ongoing computerisation programme will eventually improve the land record management system and reinforce the security of land titles, but errors in the issuance of land titles are still common and have led to an increased number of land disputes.

Meanwhile, the legal and institutional framework for protecting investors' intellectual property (IP) rights has been substantially strengthened over the past years, notably with the recent amendment of the IP Code, which has brought IP regulations closer to international best practices. Major modernisation reforms are currently being undertaken to improve the quality of IP investigation and prosecution but it is too soon to measure their impact on the quality of enforcement of IP rights.

All investors are generally well-protected against expropriation under domestic law. The law contains specific provisions granting fair and prompt compensation in case of expropriation and a right of appeal to challenge administrative decisions. These core standards of protection are drafted in general terms and are less detailed than protection guarantees provided through international investment agreements (IIAs) ratified by the Philippines, in particular the ASEAN Comprehensive Investment Agreement (ACIA) where the notion of indirect expropriation is more detailed and better delineated. This gives more predictability to investors and more policy leeway to the state than the notion of indirect expropriation contained in domestic legislation.

IIAs are another building block of Philippine investment policy. With 39 bilateral and multilateral investment agreements in force, investment flows from over 40 countries into the Philippines are potentially covered by the IIAs. The Philippines is currently reviewing its existing bilateral investment treaties in light of the Philippine Model Investment Agreement from 2009. While investment protection provisions constituted the core of the traditional IIAs in the Philippines, recent Philippine IIAs show an increasing focus on investment liberalisation provisions to facilitate the establishment of new investments. Moreover, several key investment protection provisions that are closely linked with the host state's regulatory space – particularly indirect expropriation and the fair and equitable treatment standards – have been specified and now offer more certainty to investors and governments. Both the inclusion of investment liberalisation provisions and the more specific definition of protection standards will help to modernise Philippine IIAs. The Philippine ongoing review of its IIAs should seek to ensure appropriate consistency with current investment policy goals.

This modernisation of the Philippine IIA regime comes at a time of increasing regionalisation of ASEAN investment policy. While regionalisation is an opportunity for both the Philippines and ASEAN, it creates challenges regarding the consistency of national, regional and international investment policies of the Philippines. Policy makers need to ensure that they do not lose sight of the harmonisation of investment policies – a key objective of ACIA.

Investors are given access to investor-state dispute settlement (ISDS) through Philippine IIAs, as well as, when applicable, through laws and individual investment contracts. In general, Philippine IIAs contain little regulation of ISDS, while the emerging ASEAN IIA practice tends to be more specific in managing certain risks, such as the exposure to investment claims. Moreover, attempts to increase the transparency of ISDS mechanisms have been made. The ongoing review of existing investment treaties offers an opportunity for the Philippines to take these considerations into account.

Recommendations include:

- For consistency and readability, consider consolidating the provisions of the *Investment Omnibus Code* and the *Foreign Investment Act*. This would also help increase transparency of the legal framework for investment, notably by clarifying the scope of some of the provisions of the existing legislation.

- Clarify the right of the host state to introduce new regulations by delineating the notion of indirect expropriation in domestic legislation. The definition of indirect expropriation in ACIA could serve as a model.
- Sustain efforts to improve enforcement of IP rights, notably with the creation of a dedicated IP court.
- Further secure the land titling and registration system and complete the computerisation reform, so as to increase revenue sources, reduce corruption and allow land holders to use land titles as collateral to access credit.
- Review existing IIAs to ensure appropriate consistency with current investment policy goals.
- Ensure that the modernisation of the IIAs and the ongoing review of bilateral investment treaties contribute to creating a harmonised investment policy, consistent with ACIA commitments.
- Continue clarifying core investment protection standards in Philippine IIAs, particularly with regard to the fair and equitable treatment standard.
- Adhere to the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration and continue to foster transparency in arbitral proceedings.
- Continue to manage the exposure to investment claims, for example, by providing for clear time limits for claims.
- Consider expanded use of IIAs as a tool to foster and support liberalisation of the rules on the admission of foreign investment. For example, subject to defined lists of existing restrictions, prospective foreign investors could be granted certain rights prior to their establishment, such as national and most-favoured nation treatment, in order to stimulate investment flows.

Domestic legislative and institutional framework for investment policy

Investment protection, liberalisation and regulation are at the core of the investment climate. Policy makers regulate investment in many ways to ensure that the country reaps the full benefit from investments. They pursue these objectives in their national investment framework and at the international level, notably through international investment agreements.

Both domestic and foreign investors need to know that their rights and property will be respected. By enhancing investor confidence, sound investment protection is thus likely to lead to increased levels of investment. Investment policy can also be a powerful tool to facilitate investment flows by lowering the barriers to establishing new investments.

The quality of investment policies directly influences the decisions of all investors, be they small or large, domestic or foreign. Property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all. Policy coherence has a strong impact on the investment environment, and the same standards for investment protection and openness should generally apply to both international and domestic investors. Transparency of government actions is another key principle for fostering a favourable environment for investment, reducing both uncertainty and risk for investors and the transaction costs associated with investment.

Continued reform efforts towards a sound and open investment regime

The Philippines has embarked upon major investment climate reforms. It has progressively amended its laws to create a more modern legal framework for investment. Domestic legislation has evolved over time to enshrine more legal guarantees for both foreign and domestic investors. Reform of the domestic legal framework for investment started with the enactment of the *Omnibus Investment Code* (OIC) 1987. The OIC, applicable to both domestic and foreign investment, is the main legislation governing investment, providing for the institutional framework for investment and setting out in detail the powers and responsibilities of the BOI. It also provides detailed procedural guidance for the registration of enterprises. Title II of the OIC provides for investment protection. Title III is dedicated to incentives granted to registered enterprises, and incentives given to foreign investment are provided in Book III. Unlike most of its ASEAN peers, the Philippines has not adopted a single, dedicated investment law, which would comprehensively govern both domestic and foreign investment. Numerous other laws and regulations applying to investment activities, be they sectoral or with a more general scope, create a complex web of several, sometimes overlapping laws.

Following the extension of incentives to foreign investors, Book II of the OIC (covering incentives) was separated from the OIC and enacted as the *Foreign Investment Act* (FIA) in 1991, thereby adding another layer of regulation. The FIA provides for the general legislative regime for foreign investment. The OIC and the FIA are therefore complementary. The existence of two separate laws does not mean that investors are treated in a discriminatory manner, but it requires more efforts to ensure that relevant laws are mutually consistent and also consistent with international commitments. Consolidating the two laws could help further achieving transparency and clarity of the legislation governing investment.

The transparency and predictability of investment policy have improved

Investment implies a commitment of resources in the present for an uncertain return in the future. While commercial risk is a natural part of doing business, unforeseen policy changes can also have major implications for the viability of a project. Policy predictability is one of the most commonly cited concerns of investors in surveys in all countries.

Governments can mitigate regulatory risk by providing greater certainty for investors through transparency and consultations when policy reforms are undertaken and in the way any potential disputes are handled. Investors care about regulatory risks. They are anticipated through higher hurdle rates for a project and translate into lower efficiency even if the investment goes ahead because of high expected returns. One way to enhance policy predictability is to ensure that potential changes involve substantial public consultations in the drafting phase, with the private sector as well as other stakeholders.

The Philippines has achieved a high level of transparency of investment policies, strategies and regulations through the widespread practice of consultative mechanisms within the government and with private sectors representatives. The design of investment strategies and the law-making process are conducted in an inclusive and transparent manner. Investment laws and policies are well communicated in newspapers, in the official gazette as well as on the BOI website. All relevant regulations and procedures are easily accessible to investors through well-designed and up-to-date websites. Investment promotion events such as capacity building training on investment promotion with local government units also ensure that investment policies are well communicated at all levels of government. As a result of these dissemination efforts, the investment regulatory framework has become more transparent.

One of the priorities of the 'Aquinomics' policy stance is precisely to further institutionalise public consultations in the law making process and to strengthen the appeals process against administrative decisions. Consultations with foreign investors and other stakeholders on regulatory changes are made through public hearings, consultative meetings, including Technical Working Groups, the National Competitive Council for Ease of Doing Business, and through dialogue conducted with major industrial stakeholders on a sectoral basis. In order to enhance consistency among the various laws and regulations, numerous Inter-Agency Committee consultations, public hearings, and stakeholders' engagements are undertaken. The outcome of consultations is then used as the basis for review or amendment of relevant laws and regulations.

Legal protection of investment under domestic law

The current legislative framework for investment in the Philippines contains protection guarantees for investors which are weaker and less detailed than in the IIAs ratified by the country, including ACIA (addressed below). Core protection guarantees on investment are also enshrined in the 1987 Constitution, which provides for principles of non-discrimination and protection against expropriation. The OIC gives investors guarantees that they are allowed to invest, manage business operations, hire employees and provides foreign investors with a right of residence and free repatriation of capital. It also protects against unlawful expropriation.

Definition of investment

Having clear definitions of investment and investors in a law is crucial as it determines the scope of the protection guarantees. The OIC has a comprehensive definitional section, which includes detailed and clear definitions of foreign investment and clear criteria to determine the nationality of investors. Likewise, the FIA contains a definition of foreign and domestic investors. In both laws, the determination of whether an investment is deemed foreign or domestic is based solely on nationality and does not take into account the residence of the investor. The nationality of the company is defined in a consistent manner in both laws and is determined based on the nationality of controlling investors. Both laws encompass portfolio investment and do not require a condition of durability of the investment to be eligible for the provisions and legal guarantees. As often encountered in domestic legislation, these provisions must be distinguished from the terms used by the Central Bank. For purposes of registration of foreign investment, purchase of foreign currency and repatriation of capital and income, the Central Bank uses the notion of "non-resident investor" instead of "non-Philippine national".[1]

In comparison, ACIA provides a definition of covered investment and explicitly covers portfolio investment. It provides a more detailed definition of what types of investments are covered by the scope of the treaty and that thus may benefit from the protection guarantees given in the treaty. It provides for a broad, open-ended asset-based definition of covered investments. But it also covers portfolio investment and states that the term "investment" also includes amounts yielded by investments such as profits, interest, capital gains, dividend, royalties and fees.

Protection provisions

Title II of the OIC provides for investment protection guarantees. It grants free repatriation of investment and remittance of earnings for foreign investors and protects against expropriation but does not contain several standards of protection that are often encountered in investment treaties, such as the fair and equitable treatment or the minimum standard of protection. It is also silent on investment dispute resolution. The government could consider incorporating more core investment protection standards into the investment law to strengthen the existing regime, as well as inserting a reference to available means, including arbitration, for the settlement of investor-state disputes. There is no explicit principle of non-discrimination or of national treatment, but the Constitution provides for a guarantee of equal legal protection, which means that "no person or class of persons shall be deprived of the same protection of laws that is enjoyed by other persons or other classes in the same place and in like circumstances".[2]

The OIC contains guarantees of legal certainty and predictability for investment incentives. It states that in the event of difficulties of interpretation of the incentives regime, the Code must be interpreted in favour of investors. It also provides a guarantee of legal stability to existing registered enterprises that already benefit from incentives provided by laws that have been repealed by the entry into force of the Code.

Overall, the legal framework needs to be clear and easily understandable. While no serious drafting ambiguities have been identified, unifying the *Omnibus Investment Code* and the *Foreign Investment Act* within a single piece of legislation is likely to increase the readability of the overall regulatory framework governing investment activities, as mentioned earlier. Unifying the legislation would also clarify the scope of some provisions that are meant to apply to both domestic and foreign investment, such as the provisions on environmental obligations (section 11 of the FIA, "Compliance with the environmental standards) for investors that is currently contained in the FIA but yet applies to all investors "regardless of their nationality".

Protection against expropriation

Protection against expropriation without fair compensation is one of the most crucial rights of investors and should be included in the regulatory framework through provisions establishing transparent and predictable procedures. The 1987 Constitution stipulates that "Private property shall not be taken for public use without just compensation." and that "The State may, in the interest of national welfare or defense, establish and operate vital industries and upon payment of just compensation, transfer to public ownership utilities and other private enterprises to be operated by the Government." Protection against expropriation is also provided in the OIC, as well as in the Civil Code and in the "Act to facilitate the acquisition of right-of-way, site or location for national government infrastructure projects and for other purposes". In line with the provisions of ACIA and with international good practice, the OIC provides that expropriation of private property is allowed for public use or in the interest of national welfare or defence, against compensation at fair market value. In the event of expropriation of the assets of a foreign investor, the amount received as compensation can be freely repatriated in the currency in which the investment was originally made. Investors are always granted a right to challenge expropriation decisions before domestic courts.

The procedures for expropriation, as governed by the Rules of the Court, are further described in Box 2.1.

Box 2.1. **Procedures for expropriation in the Philippines**

The procedures for expropriation are governed by the Rules of Civil Procedure and are in line with international standards: full compensation, based on a fair market value, must be paid in a prompt manner after the property has been expropriated for public use. The definition of "public use" that has been endorsed in the Philippine jurisprudence is the following: "Public use means public usefulness, utility, or advantage, or what is productive of general benefit, so that any appropriating of private property by the state under its right of eminent domain, for purposes of great advantage to the community, is a taking for public use."[3] The notion of "market value" has been expressed in different ways: "price fixed by the buyer and seller in the open market in the usual and ordinary course of legal trade and competition; the price and value of the article established or shown by sale, public or private, in the ordinary way of business; the fair value of property as between one who desires to purchase and one who desires to sell; the current price; the general or ordinary price for which property may be sold in that locality."[4] The amount given as a compensation is determined by the court having jurisdiction of the proceedings. As for the expropriation of farmland, the *Comprehensive Agrarian Reform Law* of 1988 gives the Department of Agrarian Reform the authority to determine in a preliminary manner the compensation for lands taken under the Comprehensive Agrarian Reform Program.

The rules of Court governing the assessment of the amount given as compensation require that compensation must be equivalent to the value of the property as of the time the complaint for expropriation is filed. Investors have the right to judicial review of the adequacy of the compensation and of the administrative decision of the expropriation and the "public use" nature of the expropriation.

The *de jure* regime for expropriation provides strong guarantees of protection in the event of an expropriation. Yet, according to various observers,[5] expropriation cases filed with the courts sometimes tend to be a protracted process, and payment of compensation has in some cases been considerably delayed. Expropriation cases that have occurred in the past years seem to involve local government units more often than central level authorities and relate to acquisitions made for implementing major public-sector infrastructure projects.

Although the legal provisions contain detailed and strong protection against expropriation, further fine-tuning could help in clearly determining to what extent indirect expropriation is included in the scope of the protection. Guarantees against expropriation can be interpreted very broadly, covering indirect expropriation or measures that amount to an expropriation, hence the importance of having clear and detailed language on expropriation. In order to avoid having to pay compensation for a series of legitimate regulatory measures, recent IIAs have clarified the meaning of indirect expropriation, as discussed in more detail below. It could be relevant for the government to use this evolution as a model and to further detail the expropriation provision contained in the *Omnibus Investment Code*, so as to avoid confusion on the scope of protection that it provides. Some recent laws provide that, except in rare circumstances, non-discriminatory regulatory actions to protect legitimate public welfare objectives, such as public health, safety and the environment, are not considered to constitute expropriation.

No explicit principle of non-discrimination with regard to establishment

Without prejudice to the constitutional restrictions on foreign investment, a principle of national treatment, or, alternatively, a general principle of non-discrimination could therefore be expressed in the laws governing the establishment of foreign investment. It would signal a positive and open investment policy, without prejudice to the possibility for the state to preserve its sovereign right to implement any developmental policies, as expressed in the Foreign Investment Negative List.

Access to land ownership

Secure, transferable rights to agricultural and other types of land and other forms of property are an important pre-requisite for a healthy investment environment and an important incentive for investors and entrepreneurs to shift into the formal economy. Well-defined and secure ownership, including an effective register of what constitutes public properties, encourages new investment and the upkeep of existing investments. Land titles, for example, give an incentive to owners to promote productivity enhancing investments. Reliable land titling and property registrars also help individuals and businesses to seek legal redress in case of violation of property rights and offers a form of collateral that investors can use to improve access to credit, which is one of the main obstacles to new investment, especially among small and medium-sized enterprises. Investors need to be confident that their land rights are properly recognised and protected and that they are protected against forced evictions without compensation. Tenure security does not necessarily require private ownership or a formal title. Simple land use rights, such as lease rights, can provide tenure security if they are clear and of specific duration and if the contract cannot be unilaterally broken.

The land regime of the Philippines is based on the Regalian Doctrine, which dictates that all lands of the public domain belong to the state, that the state is the source of any asserted right to ownership of land and charged with the conservation of such patrimony. The doctrine has been consistently adopted under the 1935, 1973, and 1987 Constitutions. Therefore, 'Philippine nationals' as defined in the FIA, are allowed to own land, but this is limited to ownership of alienable or disposable land. All lands not acquired by a private person or corporation, either by grant or purchase, are public lands belonging to the state.

By virtue of the "Filipino First" clause of the Constitution, land ownership is restricted to Filipinos, and all exploration, development and use of natural resources is reserved to the State. The Constitution limits the ownership and lease of public lands to nationals or to companies that meet the 60% requirement. The *Investor Lease Act* of 1994 allows foreign companies to lease land for 50 years, renewable once for another 25 years, for a maximum of 75 years. However, no nationality restrictions apply in the case of the lease of an existing building.

All lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all sources of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the state. With the exception of agricultural lands, natural resources cannot be alienated. Article XII(3) of the 1987 Constitution further provides that lands of the public domain are classified into three main categories. Private corporations may not hold alienable lands of the public domain except by lease, for a period not exceeding 25 years, renewable once and for a limited geographical scope.

By virtue of the *Land Registration Act*, land is either titled, in which case it is categorised as private land, or untitled (alienable or disposable land). As a general rule, it is presumed that land is part of the public domain belonging to the state, unless otherwise titled as private property. Private properties can either be titled; presumed to be agricultural land, previously part of alienable lands of the public domain; agricultural land may be further classified as for residential, industrial or commercial use; or private properties where ownership is limited to Philippine nationals. As for public land, it includes alienable or disposable lands which can be acquired or issued title, and non-alienable lands (*i.e.* timber or forest lands, mineral lands, national parks) where no title can be issued over any portion within this area.

Titles may be acquired over alienable or disposable land through various categories of patents or through lease contracts. Only titled land is freely transferable, yet untitled land may be transferred through the use of tax declarations. For original registration (where no title has yet been issued over a parcel of land), title may be acquired either by judicial proceedings – by filing petition for registration in Court – or through administrative proceedings. The registration of this patent becomes the basis for issuing the Original Certificate of Title by the Register of Deeds.

The land regime of SEZs follows the general restrictions in the Constitution and in relevant laws, including *the Special Economic Zone Act*, which provides that lands and buildings in each ecozone may be leased to foreign investors for a period not exceeding 75 years. The leasehold right acquired under long-term contracts may be sold, transferred or assigned, subject to the conditions set forth under the *Investors' Lease Act*. The *SEZ Act* further provides that agricultural lands may be converted for residential, commercial, industrial and other non-agricultural purposes, subject to the conditions set forth under the Comprehensive Agrarian Reform Program.

Efforts made to strengthen the registration and titling system

The Land Registration Authority has fully recognised the need for a more secure, accurate, efficient and modern land titling and registration system. The Authority, in charge of the registration and titling system for the entire territory, is currently computerising the land record management system and creating a comprehensive and up-to-date land register. A combination of microfilm and computerised database systems has been established and has already showed results in improving the security, reliability, and accessibility of land title information of registries. This should significantly increase revenue sources for the government by facilitating tax collection. Once fully established, this computerisation is expected to cut the time required to acquire land tenure rights, reduce corruption and reinforce the security of land titles. It will also facilitate the use of land titles as collateral for land holders to access credit.

The computerisation process has not always been a smooth one, as shown by problems of errors in land titles issued by the Land Registration Authority, resulting in an increased number of land disputes brought before courts, which have affected investor confidence and security of private land ownership. It will take further efforts for the government to enhance land tenure security by recording individual and collective land tenure rights, thereby facilitating the transfer of land tenure rights and allowing investors to seek legal redress in cases of violation of their rights.

Protection of intellectual property rights

Intellectual property can have significant value, and hence good registration systems are crucial. Most importantly, the protection granted to intellectual property needs to strike a balance between the need to foster innovation and competitive markets and society's interests in having new products priced affordably. Intellectual property rights can also foster technology transfers. When well enforced, they give their holders the confidence to share new technologies through, *i.a.* joint ventures and licensing agreements with local firms. In this way, successful innovations can be diffused in the country, bringing higher productivity and growth.

Despite major legislative reforms, challenges remain in the enforcement of IP rights

The Philippines was the first country in the region to adopt a comprehensive Intellectual Property (IP) Code based on the 1995 World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). The IP Code covers copyright and related rights, trademarks and service marks, geographical indications, industrial designs, patents, layout-designs (topographies) of integrated circuits, and protection of undisclosed information. Recent amendments to the IP legislation, including the amendment of the IP Code in 2013, have brought the country in line with international standards.

The Philippines has also adhered to the main international conventions on IP rights (Box 2.3) and achieved a further step towards best international standards in the protection of IP rights in 2012 by joining the Madrid Protocol, which is a procedural mechanism for the filing of a single trademark application that may have the effect of multiple national registrations in different member countries, as well as by adopting the Beijing Treaty on the protection of audio-visual performance.

Box 2.2. **Measures launched to improve the quality of IP enforcement**

The Intellectual Property Office of the Philippines, the body in charge of implementing IP laws, has made, under the auspices of the Department of Justice, ambitious efforts to improve the enforcement of IP rights, with the creation of IP taskforces at regional level. In 2012, it launched the Manual for the Investigation and Prosecution of IP Cases which provides standard procedural guidelines for law enforcers and prosecutors who will handle cases of IPR violations. It also aims to help the public in understanding IPR and the procedures for effective enforcement, as well as to improve the quality of IPR investigations and prosecution. In a move geared towards more transparency and a speedier disposition of cases, an IP Case Library has been created and made available online.

The IP Office has developed an IPR Strategy on Enforcement in order to have a holistic approach to effective enforcement of IPR. This strategy involves the crafting of an Action Plan on Enforcement for 2012-16 to enhance Inter-Agency Cooperation in the promotion, protection and enforcement of IPR. It also works hand-in-hand with the Bureau of Internal Revenue to prosecute IPR violators. With the 2013 amendment, the IP Code now grants enforcement and visitorial powers to the IP Office. To effectively implement these powers, the Intellectual Property Rights Enforcement Office was created under the direct supervision of the Director General.

Further efforts are also being made to raise public awareness and build institutional capacity. The IP Office, together with the Supreme Court and the Philippine Judicial Academy, have also developed and implemented training programmes for trial court judges and court of appeals justices. As part of its capacity building programme, it organises workshops on the rules of procedures for IPR cases for commercial court judges, prosecutors and clerk of courts. It conducts capacity-building programmes for Justices of the Court of Appeals, Judges, Prosecutors, Investigators and Hearing Officers of the IP Office. It has also established an Alternative Dispute Resolution (ADR) Programme to better deal with IP disputes. The promotion of ADR and the modernisation of rules on provisional remedies available to rights holders, such as the remedy of temporary restraining orders, has allowed for a more speedy and quality disposition of IPR violation cases.

The *de jure* protection of IP rights has long been one of the most advanced in the region, but the enforcement of IP rights has, until recently, fallen short and the slow pace of adjudication of IP disputes before domestic courts has been criticised. In the absence of specialised courts for managing IP cases, Special Commercial Courts handle all IP related cases filed in the regular courts. Yet, IP adjudication has made significant strides. Aware of the need to have specialised judicial staff on IP rights in order to deal better with the IP caseload, the government is currently considering setting up a dedicated IP court and has made efforts to sensitise better the judiciary on IP rights. The government has recently reformed IP regulation and enforcement, which has quickly shown very positive results. As a result of these reform efforts, the Philippines was removed from the USTR Priority Watch List in 2006 and subsequently from the Special 301 Watch List in 2014. The Rules of Procedure for Intellectual Property Rights Cases were promulgated in 2011 by the Supreme Court to streamline the litigation process and to expedite court procedures and reduce the backlog of IP cases. The Rules govern civil and criminal actions for violations of IPRs lodged before the Regional Trial Courts designated by the Supreme Court as Special Commercial Courts.

The Philippines is taking the lead in ASEAN on IPR enforcement plans

Over the past few years, ASEAN has been developing the IP system in the region through the ASEAN Working Group on Intellectual Property Cooperation which was established in 1996 pursuant to the ASEAN Framework Agreement on Intellectual Property Cooperation, signed in 1995. It is mandated to develop, coordinate and implement all IP-related regional programmes and activities in ASEAN. Since 2004, its work has been based on the ASEAN IPR Action Plan, 2004-10, and the Work Plan for ASEAN Cooperation on Copyrights. The IPR Action Plan was formulated "(1) to help accelerate the pace and scope of IP asset creation, commercialization and protection; to improve the regional framework of policies and institutions relating to IP and IPRs, including the development and harmonization of enabling IPR registration systems; to promote IP cooperation and dialogues within the region as well with the region's Dialogue Partners and organizations; to strengthen IP-related human and institutional capabilities in the region, including fostering greater public awareness of issues and implications, relating to IP and IPRs".

With the acceleration of the timeframe for ASEAN economic integration from 2020 to 2015, the Working Group prepared a new Work Plan as part of the Blueprint of the ASEAN Economic Community (AEC) to reflect the new objective of ASEAN. This document builds on the IPR Action Plan, 2004-10, the Work Plan on Copyrights, and the Work Plan under the AEC Blueprint in order to develop an ASEAN IP System that takes into account the different levels of capacity of the Member States, balances access to IP and protection of IPRs, and responds to the current needs and anticipates future demands of the global IP system. The Action Plan for 2011-15 is designed to meet the goals of the AEC by transforming ASEAN into an innovative and competitive region through the use of IP for their nationals and ensuring that the region remains an active player in the international IP community. The Philippines has made impressive reforms efforts to meet the goals of the current Action Plan.

Box 2.3. **Laws related to intellectual property rights**

Main IP Laws

- Intellectual Property Code of the Philippines (RA 8293) (1997) as amended by RA 10372 (2013); RA 9502 (2008) Universally Accessible Cheaper and Quality Medicines Act of 2008; and RA 9150 (2001) An Act for the Protection of Layout-Designs (Topographies) of Integrated Circuits
- RA 10365 - An Act Amending Republic Act No. 9160 (Anti-Money Laundering Act) (2013)
- Cybercrime Prevention Act of 2012 (RA 10175, 2012)
- Philippine Design Competitiveness Act of 2013 (RA 10557, 2013)
- RA 10088 - Anti-Camcording Act of 2010 (2010)
- Philippine Technology Transfer Act of 2009 (RA 10055, 2010)
- Food and Drug Administration (1963) (RA 3720, as amended by RA 9711, 2009)
- RA 9239 - Optical Media Act (2004)
- Philippine Plant Variety Protection Act of 2002 (RA 9168, 2002)
- RA 8792 - Electronic Commerce Act of 2000 (2000)
- RA 8203 - Special Law on Counterfeit Drugs (1996)
- RA 7394 - Consumer Act of the Philippines (1992)
- RA 1937 - Tariff and Customs Code of the Philippines (1957)

WIPO-Administered Treaties

- Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (25 July 2012)
- WIPO Copyright Treaty (04 October 2002)
- WIPO Performances and Phonograms Treaty (04 October 2002)
- Patent Cooperation Treaty (17 August 2001)
- Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (25 September 1984)

Box 2.3. **Laws related to intellectual property rights** (cont.)

- Budapest Treaty on the International Recognition of the Deposit of Micro-organisms for the Purposes of Patent Procedure (21 October 1981)
- Convention Establishing the World Intellectual Property Organization (14 July 1980)
- Paris Convention for the Protection of Industrial Property (27 September 1965)
- Berne Convention for the Protection of Literary and Artistic Works (01 August 1951)

IP-related Multilateral Treaties

- Agreement establishing the World Trade Organization (WTO) (01 January 1995)
- WTO – Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) (1994) (01 January 1995)

International investment agreements

International investment agreements (IIAs) have been an important element of the Philippines' investment policy framework. IIAs, entered into between two or more countries, can offer covered foreign investors substantive and procedural protection for their investments in host states; assist with the liberalisation of restrictions on investment flows; and provide for dispute resolution mechanisms.

Substantive protections generally include protection against expropriation without compensation and against discrimination, by for example guaranteeing that covered foreign investors will be treated no less favourably than investors from the host state (national treatment or NT) or third states (most-favoured nation treatment or MFN). An important policy consideration is the guarantee of fair and equitable treatment (FET) or treatment in accordance with the international minimum standard of treatment under customary international law; the FET provision has been the provision most frequently invoked by foreign investors in recent years (UNCTAD, 2012b). Additional clauses in IIAs can facilitate the transfer of profits, or limit or exclude certain performance requirements, such as local content rules.

IIAs can foster liberalisation of investment by including commitments that help to open markets to foreign investment. Liberalisation provisions can include commitments to open sectors to more foreign investment (market access) or to give prospective covered foreign investors certain rights with regard to their efforts to make investments, such as a right to national treatment, subject to exceptions.

IIAs usually provide for procedural venues to enforce government obligations. For protection provisions, most IIAs today give individual covered investors the right to bring claims against the host state before arbitration tribunals in investor-state dispute settlement (ISDS).[6] The number of ISDS claims under IIAs has risen significantly in recent years and it is estimated that there are currently over 700 such claims (including non-public claims). IIAs typically also provide for state-to-state dispute settlement (SSDS). ISDS is not always made available for liberalisation provisions and SSDS may have an important role in that area.

Recently, IIAs have come under increasing scrutiny from a variety of stakeholders, including civil society and academia, but also contracting parties to IIAs themselves. In this process, a number of core assumptions have been challenged. Econometric studies, for example, have failed to demonstrate conclusively that IIAs actually lead to increased FDI flows – a policy goal commonly associated with the investment protection regime (Box 2.4). Furthermore, while the IIA regime is often seen to advance the international rule of law and good governance in host states of investments by providing mechanisms to hold governments accountable, critics argue that its opaque legal proceedings and potential conflicts of interest of arbitrators are contrary to rule of law standards (Van Harten, 2008). Moreover, the availability of international investment agreement remedies to investors has been seen by some as an instrument that could help circumvent, and thereby weaken, domestic legal and governance institutions instead of strengthening them (Ginsburg, 2005).

Box 2.4. **Impact of IIAs on FDI flows**

A large number of studies have been published in the past two decades on whether IIAs lead to an increase of FDI flows.[7] The underlying assumption is that treaties provide for credible and enforceable protection or signal cooperation and would thus reduce investors' risks; this in turn is thought to encourage foreign investment that would not take place otherwise. These studies are almost exclusively focused on developing host countries that are associated with significant risk for foreign investors. Their findings are not directly transferable to FDI flows to advanced economies, and little research has been undertaken regarding the effects of IIAs between advanced economies.

Do IIAs lead to more FDI?

The many econometric studies that have tried to establish a correlation between existence of treaties and FDI inflows to developing countries show diverse and at times contradicting results (Bellak, 2013). Some studies find a positive correlation (Busse et al., 2008), some find a very weak, none, or even negative correlation with BITs (Aisbett, 2007, Lesher and Miroudot 2006) and some studies find a correlation between BITs and greater inflows, but not necessarily from the states with which a treaty has been concluded (Kerner, 2009; Neumayer, 2005). Studies notably find that FDI inflows do not correlate with more or less stringent dispute settlement mechanisms in IIAs (Yackee, 2008). In turn, a positive correlation is found between FDI inflows and pre-establishment national treatment provisions (Berger et al., 2010a; 2010b) and with broad free trade agreements (Büthe, 2008).

The design of these studies varies: some control for endogeneity, while others do not; some use dyadic FDI data, while others assess monadic data, *i.e.* inflows from all sources into a given country; finally, some studies differentiate among treaties with different characteristics (*e.g.* more or less stringent dispute settlement provisions, liberalisation obligations, or nature of the treaty). Differences in the study designs explain to some extent differences in the findings.

A smaller number of studies have sought to estimate the impact of specific treaties or investment provisions of specific treaties on FDI flows. These studies relate to agreements between the EU on the one hand and Canada, the United States and China on the other hand. All these studies suggest that ISDS provisions are not likely to yield more than modest benefits (Poulson et al., 2013; Schill, 2014). The Australian Productivity Commission has similarly found little evidence "that [ISDS] provisions are necessary to address potential problems faced by investors or that they generate significant benefits in practice" (Australia, 2010). Where studies predict economic benefits, these are expected to stem from liberalisation provisions expected to be included in the agreements, which remain very rare in existing agreements (Poulson et al., 2013).

Box 2.4. **Impact of IIAs on FDI flows** (cont.)

One likely reason why econometric studies have produced inconclusive or contradictory findings – in addition to the methodological differences mentioned earlier – is their reliance on standard FDI data that do not record flows between origin and ultimate destination but rather between immediate partner countries (Büthe et al., 2010). Investments that are channelled through a third or more countries for business, tax, or other regulatory motives are not counted as a flow between the origin and final destination of the investment; rather, it is recorded in FDI data as multiple flows: between the origin and the transit country, the transit country and the next destination, and so on until the ultimate destination is reached. Corporate structuring – supposedly the norm rather than the exception especially for larger companies – undermines the validity of FDI data for the purposes of the econometric studies, at least when dyadic FDI datasets are used. (Büthe et al., 2010) argue that monadic approaches are not affected.) Moreover, currently available data on FDI flows do not identify round-tripping; an apparent increase of inflows of "foreign" investment may result from a relabeling of domestic investment.

Do IIAs lead to better FDI?

It is occasionally suggested that IIAs help attract "high quality" FDI rather than more FDI. While "high quality FDI" is arguably associated with investment that encourages physical and human capital formation in the host country or has positive spill-over effects to the host economy, there are no commonly agreed criteria for the quality of FDI or its measurement, and no statistics are being established for different levels of "quality" of FDI that would underpin such assertions.

One study that assesses the responsiveness of FDI to IIAs in relation to economic sectors suggests that FDI in mining is more responsive to IIAs than FDI in utilities (Colen et al., 2013b) but does not allow conclusions on the "quality" of the investment. Moreover, the determinants that existing research has identified as influencing whether host economies experience FDI as particularly beneficial do not appear to be linked to the availability of treaty protection (Colen et al., 2013a).

In conclusion, econometric studies have so far struggled to demonstrate an increase of FDI flows resulting from the presence of an IIA but suggest that comprehensive free trade agreements and pre-establishment national treatment provisions in IIAs are positively correlated with greater FDI inflows. Different economic sectors may show different degrees of responsiveness to IIAs, but whether IIAs attract "better" FDI has not yet been subject to analysis and research. Much more needs to be done to isolate the impact of IIAs on FDI.

Philippine investment agreements

The Philippines currently has 35 bilateral and four multilateral IIAs in force (Box 2.5).[8] Some of these IIAs are stand-alone investment agreements; others are broader free trade agreements or economic partnership agreements with an investment chapter. Until 2009, the Philippines signed only bilateral IIAs. A new era in Philippine IIA policy commenced with the 2009 multilateral ASEAN Comprehensive Investment Agreement (ACIA) among the 10 ASEAN member states.[9] Since 2009, most of the Philippines' treaty making activity has been as part of broader ASEAN efforts.[10] The group of ASEAN member states has signed four additional multilateral IIAs with other states since 2009. Three of these – with Australia and New Zealand; China; and Korea – have entered into force. The fourth signed with India in November 2014 has yet to enter into force. The Philippines has thus focused its recent treaty policy on the Asia and Pacific region. Overall, roughly 75% of Philippine IIAs were signed before 2000. The Philippines' older and newer IIAs often adopt significantly different approaches to protection, liberalisation and dispute settlement.

After a delay due to priority given to ASEAN negotiations, the Philippines is currently broadening the focus of its treaty making activity. It is negotiating an investment agreement with Mexico and a free trade agreement with the European Free Trade Association, which also includes an investment chapter. The Philippines does not have an international investment agreement with the United States, which is the country's biggest source of FDI flows.

Like several other countries in Asia and elsewhere, the Philippines is currently engaged in a major policy review of its IIAs. It appears to be the first time since 1994, when the Philippines' bilateral treaty with France from 1976 was replaced, that the Philippines is actively reviewing its treaties. On 5 July 2011, the Office of the President issued a directive to review and evaluate all bilateral investment treaties according to the terms set by the 2009 Philippine Model Investment Agreement (2009 PMIA). The 2009 PMIA is not publicly available and has not been reviewed for this review. The ongoing review of the IIAs currently in force represents an ideal opportunity to address a range of issues in treaty policy.[11]

Box 2.5. **Philippine international investment agreements**

Bilateral investment agreements*

Contracting party	Date of signature	Date of entry into force
Argentina	20-09-1999	01-01-2002
Australia	25-01-1995	08-12-1995
Austria	11-04-2002	01-12-2003
Bahrain	07-11-2001	01-04-2002
Bangladesh	08-09-1997	01-08-1998
Belgium/Luxembourg	14-01-1998	19-12-2003
Cambodia	16-08-2000	13-03-2001
Canada	10-11-1995	01-11-1996
Chile	20-11-1995	06-08-1997
China	20-07-1992	09-09-1995
Chinese Taipei	28-02-1992	28-02-1992
Czech Republic	05-04-1995	03-04-1996
Denmark	26-09-1997	19-04-1998
Finland	25-03-1998	16-04-1999
France	13-09-1994	12-06-1996
Germany	18-04-1997	01-02-2000
India	28-01-2000	29-01-2001
Indonesia	12-11-2001	26-02-2002
Italy	17-06-1988	04-11-1993
Japan	08-09-2006	11-12-2008
Korea	07-04-1994	25-09-1996
Kuwait	12-03-2000	04-05-2000
Mongolia	01-09-2000	01-11-2001
Myanmar	17-02-1998	11-09-1998
Netherlands	27-02-1985	01-10-1987
Pakistan	23-04-1999	02-03-2000
Portugal	08-11-2002	14-08-2003
Romania	18-05-1994	14-06-1998 (terminated 2011)
Russia	12-09-1997	19-01-1998

Box 2.5. **Philippine international investment agreements** (cont.)

Spain	19-10-1993	21-09-1994
Switzerland	31-03-1997	23-04-1999
Syria	25-11-2009	04-05-2010
Thailand	30-09-1995	06-09-1996
Turkey	22-02-1999	19-11-1999
United Kingdom	03-12-1980	02-01-1981
Viet Nam	27-02-1992	29-01-1993

Multilateral investment agreements

Contracting parties	Date of signature	Date of entry into force
ACIA	26-02-2009	29-03-2012
ASEAN - China	15-08-2009	01-01-2010
ASEAN - India	12-11-2014	
ASEAN - Korea	02-06-2009	01-09-2009
ASEAN - Australia/New Zealand	27-02-2009	01-01-2010

*** Only those which have entered into force.**

Selected provisions in Philippine IIAs

Specifying the meaning of key investment protection standards

Investment protection standards in IIAs are typically relatively vague, especially in older treaties. This gives arbitrators in investment proceedings broad discretion to interpret and thereby determine the applicable scope of protection. Governments, including in the Philippines, have started to take a more active role in managing their investment policy. As part of this strategy, they have specified the meaning of core protection standards, such as provisions on expropriation, and specifically the meaning of indirect expropriation, and fair and equitable treatment. The specification can have considerable impact on the "policy space" of governments, which is often at stake when investors challenge the legality of regulatory measures and claim that the host state has breached its obligations under the IIA. The following section will look at the evolution of the language of core protection standards to show how the Philippines has used, and can continue to use, the specification of investment protection provisions in order to clarify their meaning and reduce the discretion of arbitrators in their application.

Direct and indirect expropriation

Most Philippine IIAs require host states not to expropriate unless the measures are taken in the public interest, on a non-discriminatory basis and under due process of law, with prompt, adequate and effective compensation. Such clauses are often complemented by provisions on the determination and modalities of payment of compensation and generally cover both direct and indirect expropriation. Direct expropriation generally refers to an actual taking of legal title to property or a physical seizure of property by a government. As a result, the host state is enriched by, and the investor is deprived of, the value of the expropriated property. Indirect expropriation is harder to define. Regulatory action or other behaviour by a government can sometimes have a dramatic effect on an investment, without involving a formal transfer of title or outright seizure. Under certain conditions, measures having an effect equivalent to direct expropriation without formal transfer of title or outright seizure can thus constitute an indirect expropriation. Provisions on indirect expropriation can affect the host state's policy space because regulatory action can give rise to claims for compensation. Most policy issues relating to expropriation arise with regard to indirect expropriation.

Early Philippine IIAs often referred to indirect expropriation in general terms.[12] Arbitrators in individual cases may consider that this leaves them relatively broad discretion to determine whether particular measures constitute indirect expropriation. Under treaties with general references to indirect expropriation, ISDS cases have used varying approaches to determine whether an indirect expropriation has occurred (UNCTAD, 2012a). The 2009 ACIA agreement reflects efforts to establish a more precise approach to indirect expropriation. The agreement recognises that measures having an effect equivalent to direct expropriation without formal transfer of title or outright seizure can constitute an expropriation. It expressly states, however, that non-discriminatory measures designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an indirect expropriation.

The ACIA clarification is contained only in the small number of Philippines agreements with ASEAN involvement, including the ASEAN agreement with Australia and New Zealand, and in the agreement signed with India; it is also referred to in the Work Programme for the ASEAN agreement with Korea.[13] The clarification is absent from Philippine IIAs prior to 2009, leaving more discretion to arbitrators in this area.

It differs from some earlier clarifications of indirect expropriation in non-Philippines treaties by being stated in absolute terms. Providing the measure falls within the terms of the clarification, liability for expropriation is excluded. In some cases, non-discriminatory measures for legitimate public welfare objectives may cause serious injury to investors, but the clarification would appear to exclude liability for indirect expropriation in such cases. Other similar clarifications leave room for findings of indirect expropriations in "rare circumstances" (which are usually undefined).[14]

The ACIA provision clarifies the limits on claims for indirect expropriation but does not address liability under other treaty provisions. ISDS cases are frequently characterised by overlapping claims for indirect expropriation and FET based on the same measure. In some cases, depending on the treaty language and arbitral interpretation, investors may be able to successfully challenge non-discriminatory measures under FET even though the measures satisfy the requirements for the exclusion of liability for indirect expropriation. The clarification does not exclude such claims. Since damages are frequently calculated using similar approaches for FET and indirect expropriation, this potential exposure needs to be carefully considered.

Fair and equitable treatment and the international minimum standard of treatment of aliens

The fair and equitable treatment (FET) standard has recently been at the centre of international investment protection and debates about treaty policy. Since the early 2000s, investors have invoked the standard in virtually every investment treaty claim (Bonnitcha, 2014). FET provisions have been subject to widely varying interpretations and the scope of protection they confer on investors is frequently unclear. Some consider that FET provisions extend to a broad range of protections for covered foreign investors. Provisions providing generally for FET have been advanced by investor claimants and applied by tribunals in a broad range of claims including relating to the stability of the legal framework, the protection of covered foreign investors' "legitimate expectations", compliance with contractual obligations, the transparency of the legal framework and regulatory measures, arbitrary government action, denial of justice, procedural propriety and due process, good faith, and freedom from coercion and harassment (Dolzer and Schreuer, 2012). Others consider that the FET provision is much narrower.

Governments have increasingly sought to define the FET or to clarify it in their new and existing investment agreements. Efforts to make the standard more precise or more limited have focused in several areas including, (*i*) clarifying or providing that the standard is limited to the customary international law minimum standard of treatment of aliens; or (*ii*) seeking to state explicitly the meaning of FET in the agreement. The efforts are also apparent in recent Philippine IIAs. For example, the 2006 Japan-Philippines Economic Partnership Agreement (EPA) expressly clarifies in a Note included with the treaty text that protection under FET is limited to the customary international law minimum standard of treatment of aliens:

> *Article 91 - General Treatment*
>
> *Each Party shall accord to investments of investors of the other Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.*
>
> *Note: This Article prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of the other Party. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens....*[15]

This approach guarantees a minimum standard of treatment defined with reference to customary international law and ensures that FET does not go beyond that standard. It closely follows the approach under the North American Free Trade Agreement between Canada, Mexico and the United States (NAFTA), as interpreted by the Contracting Parties to that treaty. The ASEAN-Korea IIA (Art. 5), ASEAN-India IIA (Art. 7) and the ASEAN IIA with Australia and New Zealand (Art. 6) similarly provide that the FET standard does not require treatment "beyond that which is required under customary international law". The FET provision limited to the minimum standard of treatment has been repeatedly interpreted under NAFTA. It has been interpreted more narrowly than FET provisions under other treaties and NAFTA governments have had much greater success than other governments in defending FET claims.[16]

A second approach to specifying the meaning of FET is to state its scope. Some Philippine treaties include FET provisions that are much narrower than general references to FET as interpreted by arbitrators. For example, the ASEAN-China Investment Agreement (2009) limits the application of its FET provision to cases of denial of justice. It includes a guarantee of FET and states that FET "refers to the obligation not to deny justice […]" (Art. 7).[17] ACIA is another example, but it appears that its definition of FET may give rise to disputes. It provides for FET and specifies that "fair and equitable treatment requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principle of due process" (Art. 11). It has been noted that this language may be read to suggest that the FET standard under ACIA is limited to the denial of justice, as it states that "treatment requires" rather than "includes" (UNCTAD, 2012b). However, covered investors may seek to argue that this reference to denial of justice merely illustrates one type of treatment that is covered by the FET provision.

The difference in scope between, on the one hand, the broad interpretations of FET referred to above, and, on the other hand, a provision limited to protection from denial of justice, is very substantial. Given the centrality of FET to many investor claims, clarification of the intent of the ACIA language could improve predictability.

While almost all Philippine IIAs refer to a guarantee of FET, they frequently only include general language.[18] Except for the IIAs with Japan and Canada, none of the IIAs entered into before 2009 contain specifications like those included in recent ASEAN agreements. The earlier agreements typically provide only that the contracting parties "shall at all times ensure fair and equitable treatment" (*e.g.* IIA with Argentina, Art. *iii*). The BIT with China provides for "equitable treatment" (Art. 3). Under these treaties, the arbitrators therefore have a broader role in determining the scope of protection and, in light of the uncertainty about the scope of FET, may reach varying outcomes.

Exceptions clauses

To seek to protect certain types of regulation from challenge providing certain requirements are satisfied, several Philippine IIAs have used other tools, often apparently inspired from international trade law, such as general exceptions clauses. They are found in several recent Philippine investment agreements. The rationale for these clauses is to ensure that the host state will not be prevented from implementing measures that pursue specific regulatory goals providing certain requirements are satisfied. Unlike clarifications limited to a particular provision, like for indirect expropriation addressed above, these provisions can apply to protect measures that satisfy their criteria from challenge under most if not all treaty provisions.

The EPA with Japan contains a general exceptions clause that applies to measures to protect human, animal or plant life or the maintenance of public order (Art. 99). The carve-out is subject to the requirement that such measures not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination against the other Party, or a disguised restriction on investments (Art. 99(1)).

Exception clauses are also regularly found in the ASEAN agreements since 2009. ACIA, for example, states that the agreement shall not prevent the adoption or enforcement of measures to protect public morals or to maintain public order, protect human, animal or plant life or health. It also exempts from liability measures to secure compliance with laws or regulations which are not inconsistent with ACIA, including those on the prevention of deceptive and fraudulent practices to deal with the effects of a default on a contract and the protection of the privacy of personal data and the confidentiality of individual records and accounts (Art. 17(1)). Equitable or effective taxation mechanisms and measures to protect "national treasures of artistic, historic or archaeological value" are also subject to ACIA's General Exceptions clause (Art. 17(1)). As in the EPA, the clause is subject to the requirement that the measures do not constitute arbitrary or unjustifiable discrimination, or a disguised restriction on investors (Art. 17(1)).

In contrast to the indirect expropriation clarification in ACIA, which refers to "legitimate public welfare objectives, such as public health, safety and the environment", the general exceptions clause in Art. 17 ACIA contains an exhaustive list of public policy goals. General exceptions clauses are a further example of the trend towards increasingly explicit statements of governmental intent. In the Philippine IIA practice, these general exceptions clauses, which address a broad set of public policy considerations, are in a few cases complemented by more targeted provisions relating to measures addressing security issues, the stability of the financial system, or efforts to safeguard the balance-of-payments.[19]

The scope of ACIA is restricted by excluding taxation measures (except for the transfer and expropriation provisions), subsidies and grants provided by a member state, government procurement, services supplied in exercise of governmental authority, and measures adopted an maintained by a Member State affecting trade in services under the ASEAN Framework Agreement on Services (para. 4). ACIA also provides that rights and obligations of member states under tax conventions shall not be affected (para. 6).

Legality of investment

In many Philippine IIAs, even prior to the multilateral ASEAN agreements, the definition of investment includes an express legality requirement, providing that only investments "admitted in accordance with the law" are investments in the sense of the agreement. Art. 4(a) ACIA also includes a legality requirement by defining the term "covered investment" as an investment "admitted according to its laws, regulations, and national policies, and where applicable, specifically approved in writing by the competent authority of a Member State".

Managing the scope of protection by specifying treaty language

The evolution of the IIA language on indirect expropriation, and fair and equitable treatment, as well as the inclusion of general exceptions clauses are an example of how the Philippines is increasingly managing its treaty policy. By specifying the scope of protection, policy makers have given more direction to arbitrators about how the treaty should be applied. These changes can thus increase the predictability of the investment protection regime under IIAs and reflect more closely the policy intentions of the contracting parties to the IIAs.

While increased predictability would likely benefit investors and governments, the specifications also reflect policy choices. In some cases, the specifications may affect the degree of protection for covered foreign investors. Policy makers need to consider the costs and benefits of these choices, and their potential impact on foreign investors as well as the host state's legitimate regulatory interests. Changes to policy in recent treaties may face additional challenges: an investor who brings a claim under one IIA may seek to invoke more favourable standards of other IIAs if the IIA between his home state and the host state provides for most-favoured nation treatment. The impact of MFN provisions needs to be carefully considered in the context of treaty reform. It is noteworthy that some of the recent Philippine IIAs narrow down the scope of the MFN provisions and provide that investors cannot invoke more favourable ISDS provisions (*e.g.* Art. 6 (footnote 4) ACIA).

Liberalising investment policy

Increasingly, IIAs are being used to liberalise investment policy: they seek to facilitate the making (or "establishment") of new investments. A key tool to foster liberalisation is to extend national treatment and the most-favoured nation standards to those seeking to make investments; these provisions are sometimes referred to as applying to the "pre-establishment" phase of an investment.

Under ACIA, national treatment is a core principle and expressly extends to the admission and establishment of new investments. ACIA provides that "Each Member State shall accord to investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory. Each Member State shall accord to investments of investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments." ACIA also provides in similar terms for MFN with regard to admission and establishment.

More broadly, the "progressive liberalisation of the investment regimes of Member States" is an explicit objective of ACIA, but ACIA limits the application of its liberalisation provisions to a defined list of sectors, including manufacturing, agriculture, fishery, forestry, mining and quarrying, and to services incidental to these sectors. The parties can agree to add further sectors to the list (Art. 3(3)). In general, liberalisation commitments of this type are also subject to express reservations and exceptions. Under ACIA, for example, the NT standard does not apply to existing measures at the central and regional level government, which are on a reservation list, and those at the local level of government (Art. 9(1)).

The multilateral ASEAN agreements also address investment liberalisation, but ACIA differs from some of the multilateral agreements entered into with third countries. While the ASEAN-Korea IIA follows the ACIA approach, the relevant provisions are subject to the work programme (Art. 27). The agreement with China provides pre-establishment MFN treatment, but not pre-establishment NT (Art. 4). The agreements with Australia and New Zealand,[20] and with India grant pre-establishment NT, but do not refer to MFN-treatment. These differences may be explained by the fact that a country may not wish to grant advantages, which it might have agreed to in exchange for other concessions, to all international partners.

In sum, the liberalisation provisions – in ACIA in particular – are carefully calibrated, targeting only specific sectors, subject to important reservations. By providing explicitly for the possibility to cover additional sectors and by aiming to reduce the reservations (Art. 9(4)), ACIA provides a framework for further investment liberalisation.

Dispute settlement mechanisms

One of the building blocks of an investment climate is the ability of its judicial and legal framework to resolve disputes efficiently and fairly. Good enforcement procedures enhance predictability in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts. When procedures for enforcing contracts are overly bureaucratic and cumbersome or when contract disputes cannot be resolved in a timely and cost effective manner, companies may restrict their activities. In the context of investment policy, investors also need mechanisms to enforce the obligations of the host state.

Dispute resolution in the domestic courts

The court system has a fundamental role in enforcing contracts and in settling disputes, both among private actors and between an investor and the state. Access to dispute resolution before Philippine courts is available to all investors without any discrimination. By virtue of the Revised Rules of Civil Procedure, any natural or juridical person, regardless of nationality, may file an appropriate case before Philippine courts. The only restriction is provided in the *Corporation Code*, which states that "a foreign corporation doing business in the Philippines without a license is not allowed to maintain or intervene in any court action, suit or proceeding."

The functioning of the judiciary has been criticised, notably for delays in managing business disputes, congested and ill-equipped courts and under-trained judicial staff. According to the US Department of State, for example, investors describe the lack of efficiency and the uncertainty of the judicial system in the Philippines as a significant impediment to a sound investment climate. Over the past decade, efforts have been made to build capacity within the judiciary as well as to raise public awareness on access to justice and available dispute resolution means. The Supreme Court, the judiciary, the Philippine Judicial Academy, law faculties and non-governmental organisations have been implementing a range of programmes addressing, inter alia, judicial reform, corruption, legal education and access to justice. The Philippine Judicial Academy created by the Supreme Court serves as the training school for justices, judges, court personnel and lawyers, conducts trainings in commercial law.

Alternative dispute resolution mechanisms, including arbitration, mediation and conciliation, are available and increasingly used for resolving domestic commercial disputes. Foreign investors can also include provisions for international commercial arbitration in their contracts relating to the Philippines.

International commercial arbitration

The Philippines has endorsed a general pro-arbitration stance. The 2004 enactment of the *Alternative Dispute Resolution Act* (ADR Act) complements the *Arbitration Law* of 1953. It has also ratified major international conventions on international arbitration and judicial cooperation and has improved its recent performance in enforcing arbitral awards, including foreign awards.

Like some of its ASEAN peers, especially Malaysia and Singapore, the Philippines has made efforts to make arbitration available for settling commercial disputes. It has adopted a holistic and integrated approach to arbitration, encompassing both domestic and international disputes in the ADR Act, reflecting a regional trend towards a less interventionist approach with regard to arbitration. The main arbitral institution in the Philippines is the Philippine Dispute Resolution Centre, a private body under the auspices of the Philippine Chamber of Commerce and Industry, which has its own arbitration rules based on the UNCITRAL Arbitration Rules (1976).

The arbitration provisions of the ADR Act largely draw on the UNCITRAL Model Law. In an effort to further promote the use of ADR, President Aquino signed an executive order in 2012 requiring all government contracts involving PPP, BOT, and joint ventures with the private sector, to include provisions for ADR, including domestic arbitration, with a view to make dispute resolution less expensive and time-consuming, particularly for large-scale capital-intensive infrastructure and development contracts.

Like all other ASEAN member states, the Philippines has ratified the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). The national courts of contracting parties to the New York Convention must generally recognise commercial arbitration awards rendered in other contracting parties, subject to narrow exceptions set out in the Convention and enforce the awards in accordance with their rules of procedure. The ADR Act incorporates the provisions of the New York Convention into domestic law. It provides that foreign arbitral awards, when confirmed by the Regional Trial Court, shall be enforced in the same manner as final and executory decisions of courts of law of the Philippines. The Act also provides that a party to a foreign arbitration proceeding may oppose an application for recognition and enforcement of the arbitral award in accordance with the Special ADR Rules only on the grounds provided for in the New York Convention; any other grounds raised shall be disregarded by the Regional Trial Court.

Ratification and incorporation of the New York Convention into domestic law marks a commitment to recognise and enforce foreign rulings and arbitration awards, both between investors and state authorities and between private parties. For investors, it is important to know that awards can and will be enforced, and the New York Convention is likely to increase investor confidence in this regard. Ratification of the New York Convention also makes it easier to enforce awards rendered in the Philippines in other countries that have ratified the Convention. The enforcement of arbitration awards could nevertheless still be improved in practice. On average, it takes around 135 weeks to enforce an arbitration award rendered in the Philippines, from filing an application to a writ of execution attaching assets, and 126 weeks for a foreign award. According to an investment climate assessment released by US Department of State in 2013, Philippine courts have also shown a reluctance to defer to the arbitral process or its resulting decisions (US Department of State, 2013).

Investor-state dispute settlement (ISDS)

Traditionally, an international investor dissatisfied with host government conduct could bring a claim in the courts of the host state. It could have recourse to international commercial arbitration if it had an arbitration agreement in a contract with the host state or a related entity. As a last resort, it could seek to convince its home state to offer diplomatic protection and assert a claim against the host state, but with no certainty of espousal of the claim.

Starting in the 1990s, direct venues for foreign investors to bring claims against host governments – ISDS mechanisms – became a frequent feature of IIAs. Under the ISDS mechanism, covered foreign investors can bring a claim for breach of the investment treaty against the government before an arbitral tribunal. OECD (2012) shows that around 96% of the global IIA stock gives investors access to ISDS.[21] With the exception of the Japan-Philippines EPA, in which the parties agreed to negotiate to establish such a mechanism (Art. 107), all existing Philippine IIAs grant investors access to ISDS.

Since 1978, the Philippines has been a contracting party to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). The ICSID system on arbitral proceedings and the enforcement of awards is largely self-contained: ICSID awards cannot be reviewed by national courts of the country in which their enforcement is sought. While a national court can refuse the enforcement of an award for reasons of public policy under the New York Convention, an ICSID award cannot be annulled on grounds of public policy. Importantly, however, the ICSID rules on enforcement only apply to ICSID awards. Awards under other arbitration rules, such as the UNCITRAL Rules or the International Chamber of Commerce, fall outside of the scope of the ICSID Convention; their enforcement is generally sought using the New York Convention.

Under Philippine IIAs, the choice between available ISDS fora is relatively narrow. Roughly half of the bilateral agreements only offer one forum, either ICSID or *ad hoc* arbitration under UNCITRAL Rules.

The main benefit commonly advanced for ISDS is that it provides a forum to settle disputes that is independent from both the host state and the investor. This view has been increasingly challenged by some groups and commentators in recent years. Issues raised in the debate include among other things the characteristics of the pool of investment arbitrators, conflicts of interest, and lack of transparency (Box 2.6). The ISDS system is today the subject of increasingly vigorous debate in many countries.

Box 2.6. **Transparency of arbitral proceedings**

The lack of transparency of arbitral proceedings features high on the list of concerns regarding the IIA regime. Investor-state proceedings usually involve issues of public interest: it is at stake when the investor challenges regulatory measures ostensibly or actually taken in the public interest, or when the host state, *i.e.* the tax payer, has to pay compensation. Transparency of arbitral proceedings is an important means to shed light on these questions and how they are dealt with. In general, the argument in favour of confidentiality is less convincing than in private proceedings, between two companies, for example. The new generation of multilateral ASEAN IIAs appears to be more advanced than the global IIA stock in this regard[22]: in both ACIA (Art. 39) and AANZFTA (Art. 26), the disputing state party has to make all awards and decisions publicly available. Non-disputing parties are entitled to receive a copy of the notice of arbitration, which helps allow them to determine if interpretive issues of interest are raised.

Beyond regulations in IIAs, regulations on transparency are sometimes provided by arbitration rules. More important consequences on the transparency of arbitral proceedings are to be expected from the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, which came into effect in 2014. Under the Rules, basic information about the dispute has to be made public through UNCITRAL's Transparency Registry; written submissions by the disputing parties, non-disputing parties and third parties have to be made publicly available; the oral hearings are open to the public and transcripts of those hearings have to be made publicly available; finally, all orders, decisions and awards are made publicly available. The requirements are subject to certain requirements regarding confidential and protected information.

In principle, the Rules apply to any UNCITRAL arbitration under an IIA that was concluded on or after 1 April 2014. (This is not the case when contracting parties to the IIA exclude the application of the Rules; or when the IIA allows them to exclude the application, and both disputing parties agree to do so). For IIAs concluded before that date, the Rules only apply if the disputing parties agree to the application, or the contracting parties provide for their application on or after 1 April 2014. By signing and ratifying the UN Convention on Transparency in Treaty-Based Investor-State Arbitration, open for signature since 17 March 2015, a country makes the Rules applicable to its IIAs concluded before 1 April 2014. The UNCITRAL Transparency Rules constitute a major step forward and the endorsement of the Convention by the Philippines would send a strong signal that the Philippines supports transparency in investment arbitration.

Managing exposure to investment claims

Claims for reflective loss

Philippine IIAs generally do not expressly address the issue of claims by shareholders' reflective loss. (Shareholders' reflective loss is incurred as a result of injury to "their" company, typically a loss in value of the shares; it is generally contrasted with direct injury to shareholder rights, such as interference with shareholder voting rights.) Advanced systems of corporate law generally bar individual shareholder claims for reflective loss. Only the directly-injured company can recover the loss.

In ISDS claims brought under typical bilateral investment treaties (BITs) that - like the Philippines treaties - do not expressly address the issue of reflective loss, arbitrators have consistently permitted shareholders to claim for reflective loss. Outcomes for shareholders thus differ under advanced systems of corporate law and typical BITs (Gaukrodger, 2013, pp. 32-51).

Many ISDS claims today are by foreign shareholders for reflective loss. Extensive analysis and discussion of shareholder claims for reflective loss at the OECD have demonstrated that the availability of reflective loss claims raises a broad range of policy issues for governments.[23] These include the risk of multiple claims and inconsistent decisions arising out of a single injury, exposure to double recovery, the impact on predictability, hindering settlement, facilitating treaty shopping by investors, and upsetting the hierarchy of claims against corporate assets under corporate law so that a claimant gets better treatment than under normal legal principles (FOI Roundtable 19, pp. 18-19). To date, no strong arguments have been identified to explain the different approach taken in investment treaties as opposed to advanced corporate law. It is widely recognised by governments that the issue merits further attention (FOI Roundtable 19, pp. 18-19). The Philippines could consider addressing the issue of reflective loss expressly, for example through clarifications to treaty language.

Amicable dispute settlement, cooling-off periods and time limits for claims

Typically, international investment agreements only offer ISDS as a last-resort remedy and state a preference for amicable dispute settlement mechanisms. Most agreements, both in the Philippines and in international practice, provide that the parties must engage in amicable efforts to resolve a dispute, often subject to relatively long so-called "cooling-off" periods. For the Philippines, these periods are up to 18 months long (ACIA).

Box 2.7. **Philippines investment arbitration experience**

Investors from the Philippines have not brought any known ISDS cases on the basis of the various Philippine IIAs, but the Philippines is listed as a respondent in four known IIA cases, which were all administered under the ICSID Convention. In one case, brought by a Swiss investor invoking the umbrella clause of the Philippines-Switzerland IIA from 1997, the tribunal stayed the proceedings and the parties settled (ICSID Case No. ARB/02/6). Another case, brought in 2011 by a Belgian claimant on the basis of the Philippines-Belgium/Luxembourg IIA from 1998, is still pending (ICSID Case No. ARB/11/27). Two highly publicised awards were rendered on claims by a German investor on the basis of the Germany-Philippines IIA from 1997, brought in 2003 and 2011 respectively. Both awards were brought for the same dispute and in both cases the tribunal declined jurisdiction because the investment had been made in violation of Philippine law, therefore falling outside the scope of application of the Germany-Philippines IIA.

In 1999, the investor Fraport, a German airport company, became the shareholder of PIATCO and other concessionaires of the Philippine Department of Transportation and Communication for the construction and operation of a terminal at Ninoy Aquino International Airport. In addition to directly or indirectly acquiring majority ownership of PIATCO, the German investor entered into confidential shareholder agreements to gain managerial control of the company. Public utilities, such as the terminal in question, were subject to nationality restrictions under the Philippine constitution and foreign ownership and control legislation known as the Anti-Dummy Law. The Philippine Supreme Court held that the control of the German investor violated these provisions and declared that the concession agreements were null and void. The investment was subsequently expropriated. Fraport brought a first claim, but the ICSID Tribunal declined jurisdiction on the ground that the investment had been made in violation of Philippine law. In doing so, it disregarded the local prosecutor's finding that Fraport had not violated Philippine local law. The Tribunal held that it rightly did so because the Prosecutor had not been aware of the confidential shareholder agreements granting Fraport control.

The award was later annulled, however. The ICSID annulment committee highlighted several shortcomings and notably found that it was possible that the Prosecutor had been well aware of the shareholder agreements without leading him to find a violation of Philippine law. Further, the committee pointed to the Tribunal's decision not to let the parties present further submissions on this question. In sum, these elements constituted a serious departure of a fundamental rule of procedure, giving grounds for annulment of the award under the ICSID Convention. After the annulment, the German investor brought the new claim, for which the second Tribunal also declined jurisdiction, finding, again, that the investment made in violation of the Anti-Dummy Law was outside the scope of protection of the IIA pursuant to the definition of investments as those "accepted in accordance with the respective laws and regulations". Even though both Tribunals declined jurisdiction, and the Philippines was not ordered to pay money to Fraport, it incurred costs for its own legal counsel and fees and expenses of the Tribunals for the first case and it was only reimbursed for parts of its cost for legal counsel in the second case.

While investors can generally only bring claims that have arisen after the entry into force of an IIA, few agreements specify for how long after the alleged violation of the IIA such claims can be brought. The post-2009 multilateral ASEAN agreements constitute an exception in this regard by providing that the submission of the investment dispute shall take place within three years of the time at which the investor became aware, or should reasonably have become aware, of a breach of an obligation of the host state under the IIA (*e.g.* Art. 34(1)(a) ACIA).

The recent creation of the Investment Ombudsman team (see Chapter 3 on *Investment Promotion*) could help to prevent investment disputes. Given that the Philippines is involved in several international arbitration cases, the government should pay particular attention to available investment prevention mechanisms. In addition to its mandate to deal with grievances against investment promotion unit agencies, the Investment Ombudsman team could be tasked to identify at an early stage issues faced by investors so as to prevent the emergence of disputes that would be costly for both parties and affect the country's reputation. It would help to minimise potential areas of dispute through extensive planning in order to reduce the number of conflicts that escalate or crystallise into formal disputes.

Scope of application of ISDS provisions

In general, ISDS provisions can only apply to issues and disputes that fall under the investment agreement itself (Box 2.8). Consequently, the substantive scope of protection of IIAs is an important tool to manage investor access to ISDS. Typically, however, the scope of application of the ISDS provisions is even narrower than the scope of application of the IIAs: some substantive obligations cannot be enforced by the investor through ISDS. The focus on liberalisation commitments in recent Philippine IIAs notwithstanding, prospective investors cannot bring claims to enforce these commitments.[24]

Pre-establishment commitments are carefully excluded both from the definition of covered investments and from the scope of application of the ISDS provisions: while the ASEAN IIAs extend the coverage of the NT and MFN standards to the "admission, establishment, acquisition, expansion, management, conduct, sale or other dispositions of investments (*e.g.* Art. 5 and 6 ACIA), the ISDS clause only refers to obligations under these articles "relating to the management, conduct, operation or sale or other disposition of a covered investment" (*e.g.* Art. 32 ACIA). NT and MFN obligations relating to the admission, establishment, acquisition and expansion" of investments are omitted. While this exclusion might seem surprising at first, it is questionable whether prospective investor would in any event be in a position to bring a claim and to show that they have incurred a loss. More importantly, these liberalisation commitments are subject to state-to-state dispute settlement mechanisms.

Box 2.8. **Scope of substantive protection under IIAs**

Protection under international investment agreements is typically only afforded to covered foreign investors. The definition of covered investors and investments therefore has an important influence on the scope of application of IIAs. In many Philippine IIAs, even prior to the multilateral ASEAN agreements, the definition of investment includes a legality requirement, providing that only investments "admitted in accordance with the law" are investments in the sense of the agreement. Art. 4(a) ACIA also includes a legality requirement by defining the term "covered investment" as an investment "admitted in according to its laws, regulations, and national policies, and where applicable, specifically approved in writing by the competent authority of a Member State". Both ICSID cases by German investor Fraport were dismissed because the investment, not made in accordance with the law, was not covered by the relevant Germany-Philippines IIA. The investment definition in ACIA also serves to broaden the scope of application of the agreement: the term "investment" covers portfolio investments ("shares, stocks, bonds and debentures and any other forms of participation in a juridical person and rights or interest derived therefrom" (Art. 4(c)(ii))) and intellectual property rights (Art. 4(c)(iii)), for example.

Some agreements also clarify the scope of application in a separate article. In Art. 3, ACIA states that its provisions apply to investors and investments (para. 1), existing as of the date of entry into force and/or made thereafter (para. 2). The liberalisation provisions, which play a crucial role in ACIA, only apply to the specific sectors listed in paragraph 3 and to services incidental to these sectors. The parties can later agree to add further sectors to this list. The scope of the agreement is further restricted by excluding taxation measures (except for the transfer and expropriation provisions), subsidies and grants provided by a member state, government procurement, services supplied in exercise of governmental authority, and measures adopted and maintained by a member state affecting trade in services under the ASEAN Framework Agreement on Services (para. 4). Lastly, ACIA also provides that rights and obligations of member states under tax conventions shall not be affected (para. 6).

Harmonising investment policies towards foreign investors

Philippine investment policy is becoming increasingly complex and sophisticated. The network of national and international provisions on the regulation of investment, investment protection and liberalisation has grown. Increasingly, decisions on investment policy are not taken by the Philippine government in bilateral relations but are subject to collective efforts of the

ASEAN member states. This "ASEAN way" offers opportunities for the Philippines to further rationalise its national and international investment policy. ASEAN is committed to establish the region as an integrated investment area (Art. 24 ACIA) and harmonising investment policies is among the chief strategies to achieve this goal (Art. 26 ACIA).

Philippine policy makers should address how the various international obligations towards covered foreign investors under its bilateral and multilateral IIAs interact. They should consider reviewing the existing stock of IIAs to ensure appropriate consistency with current investment policy goals; and strengthening efforts to ensure the Philippines national and international investment policies are designed and implemented consistently.

Consistency of multilateral and bilateral investment agreements

The important similarities between ACIA and subsequent IIAs between ASEAN and third countries testify to the strategy to harmonise the region's international investment policy. The Philippines has not signed any bilateral IIAs since 2009 but is currently negotiating a bilateral agreement with Mexico and a free trade agreement with the EFTA states, which also includes an investment chapter. Moreover, the Philippines is actively pursuing a review of its existing bilateral agreements. If the region wishes to create a fully integrated investment area, important differences in investment agreement provisions of bi- and multilateral agreements do not contribute to this goal. It is advisable for Philippine policy makers to take these considerations into account, also with respect to their own model agreement, which is the basis for the ongoing review of the Philippine IIAs. In order to guarantee an integrated and harmonised approach to international investment policy, it is not only necessary to focus on future agreements, however. Existing bilateral agreements, entered into between individual ASEAN members and third countries, also need to be considered.

As noted in OECD (2014), ASEAN's approach to adding new layers of multilateral investment agreements on the existing bilateral agreements, increases at least temporarily the complexity of the network of international obligations. The Philippines already has international investment agreements in force with Myanmar, Thailand, Viet Nam, Cambodia and Indonesia. The entry into force of ACIA in 2012 thus creates an additional layer of investment protection and liberalisation agreements with the first three countries. Art. 44 of ACIA provides that "Nothing in this Agreement shall derogate from existing rights and obligations of a Member State under any other international agreements to which it is a party". ACIA then presumably leaves the obligations under the previous bilateral agreements untouched, so that investors may still bring claims on the basis of older, sometimes more favourable, agreements. Similarly, the investment chapter of the free trade agreement with the EFTA states, which is currently being negotiated, could add an additional layer of investment protection in investment relations with Switzerland.

Similar challenges arise with the new extra-ASEAN agreements. The Philippines has bilateral agreements with both China and Korea, which entered into force in 1995 and 1996 respectively. The ASEAN-China and ASEAN-Korea IIAs, which entered into force in 2010 and 2009, create new obligations covering the same investment relations. Both multilateral IIAs provide that they do not derogate from existing rights and obligations. The ASEAN-India agreement, which is not yet in force, does not contain any language to regulate its relations with previous agreements. Since the Philippines has a bilateral IIA in force with Australia, the compatibility question also arises with regard to the free trade agreement between ASEAN, and Australia and New Zealand (AANZFTA). AANZFTA not only states that nothing in it shall be construed to derogate from obligations under other agreements; it also provides that "In the event of any inconsistency between this Agreement and any other agreement to which two or more Parties are party, such Parties shall immediately consult with a view to finding a mutually satisfactory solution" (Chapter 18, Final Provisions, Art. 2(2) and 2(3), Relation to Other Agreements).[25]

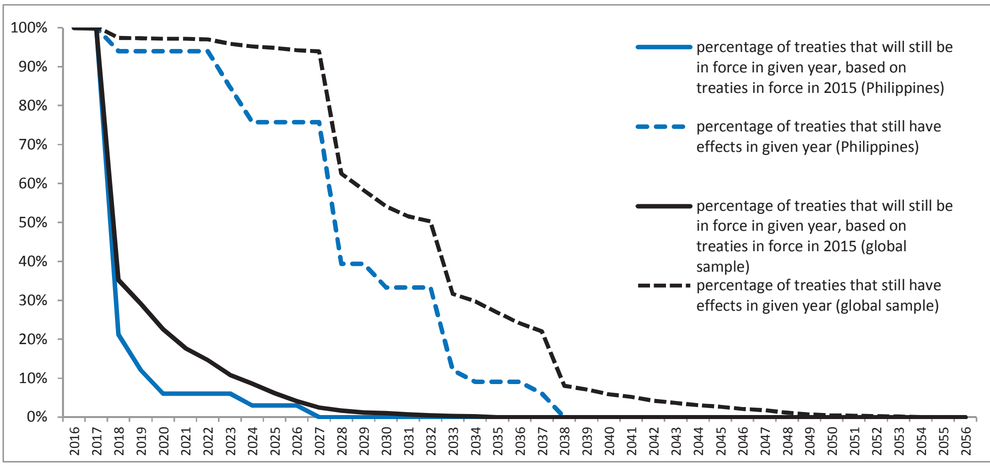
The increasing complexity of the network of international obligations in the ASEAN context should be addressed by the Philippines.

Review of existing IIAs to ensure consistency with current investment policy goals

The Philippines' ongoing review of its IIAs offers an opportunity to consider whether and how to align older treaties with current policies. As outlined in various sections above, treaty practice has evolved significantly in recent years. Many governments have sought to define the scope of their obligations more precisely, to limit the scope of obligations or to undertake new ones in important areas. These modifications may often be of interest with regard to existing treaties.

In addition to determining whether particular provisions should be modified, eliminated or added, the Philippines should consider the time dimension of its treaty practice. Many investment treaties have lengthy terms and survival clauses. This is a factor to consider with regard to policies on the renegotiation of treaties. Figure 2.1 provides a timeline for the Philippines' IIA obligations, showing for how long its IIAs are still in force and for how long they will have effects, even beyond termination. If the Philippines decided to exit their pre-2009 IIAs, for example, the termination of the last agreement would take effect in 2024. Through sunset clauses, which grant investors rights beyond termination, the Philippines' exposure – and the protection of its investors abroad – would last until 2038 for some of these IIAs.[26] The timeline for the Philippines' IIA obligations will also inform the country's ongoing review process of the existing bilateral investment agreements.

Figure 2.1. **IIA obligations over time**



Harmonisation of investment frameworks across ASEAN countries

The table below shows where the Philippines stands, in comparison with other ASEAN countries, in its regulatory framework for investment. Among ASEAN countries, it has one of the most robust and comprehensive legal frameworks for the protection of investment. Its laws and regulations enshrine core principles and guarantees such as the principle of non-discrimination, the protection against expropriation and the guarantee of free transfer of funds. In addition to its network IIAs, the country has also widely adopted the recourse to investment arbitration as a means to solve disputes between investors and public authorities, as shown by its adherence to the ICSID and the New York Convention.

Table 2.1. **Regulatory frameworks for investment in ASEAN member states**

	Vietnam	Thailand	Philippines	Myanmar	Malaysia	Indonesia	Lao PDR	Cambodia
Existence of a single investment law covering domestic and foreign investments	Yes	2 investment laws	2 investment laws	2 separate laws for domestic and foreign investments	No	Yes	Yes	Yes
Guarantee of non-discrimination at post-establishment stage enshrined in domestic legislation	Yes	No	Yes	No	No	Yes	Yes	Yes, except for land
Negative list approach	Yes	Yes	Yes	Yes, but inadequate	/	Yes	/	/
Protection against expropriation	Yes	Yes, but incomplete	Yes	Yes, but incomplete	Yes	Yes	Yes	Yes, but incomplete
Guarantee of free transfer of funds provided by law	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Possibility to recourse to investment arbitration provided by law	Yes	Yes	Yes	Yes, but unclear	Yes	Yes	No	Yes
Adherence to international conventions on arbitration (ICSID Convention, & New York Convention)	Not a member of ICSID	ICSID Convention signed but not yet ratified	Yes	Not a member of ICSID. Adhered to NY Convention in 2013	Yes	Yes	Not a member of ICSID	Yes
Adherence to International Investment treaties (including BITs and FTAs)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Consistency of levels of protection contained in investment law instruments

Interplay between instruments

In the ongoing review process of its IIAs, the Philippines should take into account that the protection it offers to investors is contained in different bodies of law: domestic legislation and constitutional protection on the one hand, and international treaties on the other. Modifications of one body of law may be ineffective if other bodies of law are left unchanged. For example, introducing more specific language in the indirect expropriation provisions of treaties to protect non-discriminatory regulatory measures may prove ineffective if the legality of those measures can be challenged successfully under the Constitution or *Omnibus Investment Code*. As noted above, this issue can also arise with different provisions in the same type of instrument, such as indirect expropriation and FET provisions.

Treatment of domestic and foreign investors

In general, the Philippines should seek to guarantee a sound investment climate for both domestic and foreign investors. Parts of the Philippines' legal framework applicable to investment protection, such as its constitutional equal protection provision, apply to both domestic and foreign investors. Philippine law also contains many provisions that exclusively cover only some foreign investors, such as IIAs, or only foreign but not domestic investors, such as the *Foreign Investment Act*. The Philippines should consider whether distortions to efficient investment decisions may occur as a result of more favourable regulatory conditions for certain investors based on nationality. At the same time, many governments see the value or the need to provide certain extra incentives and guarantees to attract foreign investment in a highly competitive market for that investment. The balance between these interests is a delicate one and may evolve over time.

Levels of protection offered to different foreign investors

Different levels of protection may exist not only as between domestic and foreign investors, but also between different groups of foreign investors. This occurs due to different provisions in IIAs or the absence of IIAs with some economic partners. The Philippines should consider the policy rationale for granting different levels of protection to different foreign investors. Reasons for granting specific advantages in some IIAs may consist in concessions that the partner country gives to the Philippines. Broader economic agreements, such as free trade agreements, appear to be particularly well-suited for such trade-offs. The application of MFN provisions also needs to be considered in this context.

Notes

1. As based on the International Monetary Fund's Balance of Payments Manual, 6th Edition.
2. *Tolendino v. Board of Accountancy* (90 Phil 83, 90 (1951).
3. *Gohld Realty Co. v. Hartford* [104 A. 2d 365, 368-9 (Conn. 1954)].
4. *Manila Railroad Co. v. Fable* [17 Phil. 206, 208 (1910)]; *City of Manila v. Estrada* [25, Phil. 208, 215 (1913)]; *City of Manila v. Corrales* [32 Phil. 85, 92, 98 (1915)]; *Manila Railroad Co. v. Velasquez* [32 Phil. 286 (1915)]).
5. USTR Investment Climate Statement 2015, as well as private sector representative interviewed by the OECD team in Manila, in November 2014.
6. For analysis of policy issues raised by ISDS from a governmental perspective, see the work of the OECD-hosted FOI Roundtable on ISDS since 2011. For an overview of characteristics of ISDS and policy issues, see Gaukrodger, D. and K. Gordon (2012). This paper was the subject of a public consultation in 2012: For statistical comparisons of the language of a large sample of IIAs, see Pohl et al*.* (2012).
7. The following literature review builds on the analysis of (Sauvant, 2009; Colen et al., 2013a) as well as on-going work of the Freedom of Investment Roundtable.
8. Four other IIAs have been signed but are not in force.
9. ACIA itself was built on the Framework Agreement on the ASEAN Investment Area signed in 1988 and the ASEAN Investment Guarantee Agreement.
10. The Philippines is currently engaged in ambitious negotiations to expand the coverage of IIAs, particularly in the context of economic partnership agreements, such as the Regional Comprehensive Economic Partnership Agreement (RCEP) among the 10 ASEAN countries and the six countries with which ASEAN has existing agreements (Australia, China, India, Japan, Korea and New Zealand).
11. As in other areas, this Review addresses only selected aspects of treaty policy.
12. *e.g.* IIA with Germany, Art. 4(2): investment "shall not be subjected to any direct or indirect measure the effects of which would be tantamount to expropriation […]"; IIA with Korea, Art. 5(1): "Each Contracting Party shall not take measures of expropriation, nationalization or dispossession, either direct or any measure equivalent thereto […]".

13. The Work Programme contains a list of issues that the contracting parties agreed to negotiate upon.

14. US Model Agreement (2012), Annex B(4)(b): "Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations."

15. Japan-Philippines EPA, Art. 91.

16. As of 2010, the 78% NAFTA government success rate in defending MST-FET claims was much higher than the 38% success rate of governments for FET claims under other treaties. See UNCTAD, Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements II (2012), p. 61 ("By October 2010, tribunals [had] addressed the merits of FET claims in 84 treaty-based disputes.... In NAFTA cases, only 22 per cent of those claims were accepted (4 out of 18); in BIT cases, 62 per cent were accepted (41 out of 66).").

17. Denial of justice is widely regarded as referring to "a particular category of deficiencies on the part of the organs of the host state, principally concerning the administration of justice." Brownlie (2007, p. 529). But it is used with a much broader meaning by some tribunals.

18. The 1994 Agreement with Korea provides for protection from expropriation and for NT and MFN, but not for fair and equitable treatment.

19. Examples include clauses on security issues (*e.g.* Art. 99 Japan-Philippines EPA; Art. 18 ACIA; Art. 22 ASEAN-India; Art. 21 ASEAN-Korea), the stability of the financial system (*e.g.* Art. 101 Japan-Philippines EPA; Art. XI Canada-Philippines) and – these provisions are widespread in the ASEAN IIAs – measures to safeguard the balance-of-payments (*e.g.* Art. 16 ACIA; Art. 11 ASEAN-China; Art. 12 ASEAN-India; Art. 11 ASEAN-Korea; Chapter 15 AANZFTA).

20. The work programme of AANZFTA provides that the parties shall enter into discussions with a view to agreeing on MFN treatment to the investment chapter (Art. 16(2)(a)).

21. www.oecd.org/investment/investment-policy/WP-2012_2.pdf.

22. The 2012 OECD review of the global IIA stock shows that only 8 of the more than 1600 bilateral agreements contain provisions regarding public access to hearings of arbitral tribunals and only 35 provide for publication of awards.

23. Cf. Eilís Ferran, Summary of FOI Roundtable 19, pp. 18-19. In addition to shareholders, creditors can also suffer reflective loss and may be able to file claims for such loss under some treaties.

24. While the Japan-Philippines EPA did not contain an ISDS clauses at all when it was negotiated – the parties agreed to enter into negotiations for ISDS –, the Canada-Philippines IIA excluded pre-establishment commitments from the scope of ISDS in Art. 2(V).

25. Under Chapter 18, Art. 2(4), contracting parties are not prevented from entering into investment agreements with any of the other contracting parties: "Nothing in this Agreement shall prevent any individual ASEAN Member State from entering into any agreement with any one or more ASEAN Member State and/or Australia and/or New Zealand relating to trade in goods, trade in services, investment, and/or other areas of economic cooperation."

26. For more detail on the calculation see www.oecd.org/investment/investment-policy/WP-2013_4.pdf

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Chapter 3

Investment promotion and facilitation in the Philippines

This chapter assesses the performance of the Philippines in promoting itself as a destination for foreign investment. It looks at the role of investment promotion in the overall development strategy, at the institutional structure for promotion, the role of monitoring and evaluation, including of incentives, and of the success of some ecozones in reducing red tape for investors. It also considers how to improve coordination among the many investment promotion agencies and with local government units.

Investment and jobs are central to the Philippines' economic development agenda and critical in achieving its inclusive growth objectives.[1] The government's investment promotion and facilitation strategy reflect these priorities. Investment promotion and facilitation can be powerful means to attract investment and maximise its contribution to development, but their success depends on the quality of investment-related policies and on the overall investment climate. Successful promotion requires a careful calculation of how to employ resources most effectively, guided by evaluations of costs and benefits; badly designed investment promotion and facilitation strategies can be costly and ineffective. Investment promotion is about promoting a country or a region as an investment destination, while facilitation is about making it easy for investors to establish or expand their existing investments. Effectively implementing the two functions requires specific activities, strategies, skills and the necessary budgets.

The Philippines has sophisticated institutions and measures to promote and facilitate investments. It has 18 official investment promotion agencies and hundreds of special economic zones, commonly referred to as ecozones. It also has a strong international investment promotion network consisting of 26 Philippine Trade and Investment Centres in key markets. The Philippine Investment Promotion Plan (PIPP) network was created to ensure good co-ordination of investment promotion and facilitation. The Board of Investments (BOI) acts as the technical secretariat of its steering committee, and a common platform – Invest Philippines – was launched. The BOI's aftercare programme and the investment ombudsman function address investment facilitation.

While there is merit in having different agencies providing tailored services and products to potential and established investors, having so many IPAs poses obvious co-ordination challenges with risks of duplication and overlaps of activities between the agencies. This can also lead to investor fatigue from being approached by different bodies. Further harmonisation of investment promotion activities under one lead agency would help to ensure that foreign investors perceive a single point of contact for facilitating their investments. Harmonisation goes beyond joint branding and communication towards a more unified and rationalised investment incentives structure. Current efforts at rationalising incentives across the Philippines deserve new momentum so as to allow the revenue authorities to support good practice incentive management. The new *Tax Incentives Management and Transparency Act* (RA 10708) calls for full reporting on incentives offered by all IPAs and for cost-benefit analysis to provide incentives more effectively

The BOI plays a central role in crafting the yearly updated Investment Priorities Plan (IPP), a roadmap for investment-related policies and for measuring progress. Recent important modifications include streamlining of targeted activities, better continuity in the content to enhance policy predictability, and aligning better with the Philippine Development Plan. The private sector is also more effectively involved through Industry Roadmaps launched in 2012, channelling private sector perspectives on opportunities and challenges into the policy-making process – an important innovation in how the government interacts with business which is likely to boost business confidence in the public administration.

In terms of investment facilitation, business licensing procedures have been streamlined through one-stop-shops, such as BOI's Investments Assistance Service. Some ecozones are internationally recognised for their good practice in business facilitation, such as the Philippines Economic Zone Authority (PEZA), with 326 zones and more than 3 543 registered enterprises (as of May 2015). Some remaining challenges need to be addressed, however, as the Philippines struggles to improve its international rankings in areas like setting up a business, particularly the capacity and resources of local government units to facilitate investment effectively.

Ecozones in the Philippines have contributed to attracting investment in export-oriented manufacturing, as seen in the rapid increase in electronics exports in the 1990s (OECD, 1999). Development paradigms traditionally based on export orientation have shifted towards new models of international trade and investment. Global value chains (GVCs) and the growth of global production networks are changing the way the benefits from trade are assessed. New ways of measuring domestic value addition, such as through the trade in value added (TiVA) approach, shed light on how well countries are integrated in GVCs and what proportion of their exports are domestically produced inputs (OECD, 2013a).

Given the focus on inclusive development in the 2014 IPP, these innovations are important. Increasing local value addition in production and exports is important, but so is integrating the lower ends of the value chains to promote inclusive growth, including producers of primary inputs, SMEs and small-scale farmers. This calls for a fresh look at the impact of the activities of multinational enterprises and the linkages they create with local companies so as to encourage technology and knowledge transfers vital for more domestic participation in GVCs.

Ecozones are particularly important in this regard; they have significantly contributed to Philippine exports, but their impact on the domestic economy beyond job creation through activities in the zones is limited, as is typically the case for special economic zones (SEZs). The type of activity these zones promote should also be considered in the policy mix, as with the rise of GVCs, supply chain management becomes ever more important, encompassing not only manufacturing but also logistics and services. Governments now need to think beyond "what" their economies produce, to "how" they produce.

Policy options

While the Philippines has been actively and to some extent successfully promoting investment, all these efforts will fall short of contributing fully to inclusive growth and the broader development agenda if some structural challenges are not tackled, particularly the need to create dynamic linkages between MNEs and the domestic economy. Below are some policy options that the government could consider.

Investment Promotion and facilitation

- **From strategy to implementation**: The IPP and recent innovations, including the industry roadmaps, have provided the government with a tangible investment strategy. The next step should now be to implement the strategy through concrete measures, including well-informed investment targeting and linkages promotion.

- **Further harmonise investment promotion**: Despite efforts to bring together 18 IPAs under a coherent investment promotion system, foreign investors are still not provided with a single counterpart. This creates confusion and fatigue among investors and also puts a strain on public resources that have to ensure complementarity of activities and avoid unnecessary duplication. The Philippines would greatly benefit from a strong agency that leads national investment promotion efforts. In the meantime, the BOI's role as the coordinator of the investment promotion agencies and their activities should be strengthened, but without putting the other agencies at a disadvantage in undertaking their investment promotion activities. This would also strengthen and clarify the reporting lines of the agencies – a critical aspect of effective investment promotion – and will increase the accountability of the agencies.

- **Improve doing business using local solutions**: The Philippines showcases a number of good practices in streamlining business regulations and licensing in some of its ecozones. The lessons from PEZA or the Clark Development Corporation should be replicated outside these ecozones. This includes building capacity of the local government units and clearly monitoring the progress of related activities.

- **Better monitor and evaluate investment promotion**: This not only strengthens accountability but also improves IPA performance. Key performance indicators should go beyond jobs created and investments accrued to include elements such as the number of expansion projects, number of research, development and innovation projects, investment in research, development and innovation projects, percentage of jobs approved with decent salaries, and average salary in new investments to address the quality of the investment. The client charters of some IPAs also fall short of their objectives, while others are good practice.

- **Harmonise the investment incentives system**: The large number of laws covering the incentives regime adds to complexity and undermines transparency, thus straining the public administration and confusing investors. International experience suggests having tax administration bodies handling incentives, not least because IPAs face capacity and resource constraints in handling tax matters.

Promoting business linkages for inclusive growth

- **From a zone-based strategy to dynamic clusters:** The existence of industry clusters at the local level represents an important location factor for many MNEs. The government should be encouraged to reconsider its zone based strategy, to incorporate the successes of its ecozones, particularly in improving business climates, while addressing the lack of dynamic linkages created with the local economy. The Philippines is ripe for a more elaborate and comprehensive strategy of cluster development. The DTI, through its Regional Development Group, launched a clusters initiative in 2013 but is encouraged to use the ecozones more in its implementation. Ecozones have demonstrated significant enterprise agglomeration effects, gathering numerous MNEs and local investors which could be a stepping stone to building dynamic clusters if accompanied by appropriate measures that support critical elements such as industry-guided SME promotion in surrounding areas and collaborative arrangements with competent research and higher education institutions. Financial institutions should be involved in addressing financing constraints of SMEs in these schemes.

- **Promoting non-zone industry creation:** Employing collaborative approaches between SMEs, research and training institutions and MNEs located in the zones is recommended as a way of promoting linkages around zones. A related challenge is the capacity of technical and research institutions to effectively provide the appropriate training to local industry – this can be resolved through close involvement of MNEs with advanced technology and know-how in the curriculum development and delivery. The momentum and platform created through the industry roadmaps could be used to channel private sector needs to vocational training programmes.

- **Encourage zone developers and managers to promote linkages:** Zone developers and managers have very specific tasks linked to the development and management of their zones. Their mandates should be extended to support linkages creation (match-making, facilitating SME-MNE networks etc.), backed by a reward system. Since the new IPP stresses a value chain approach, the IPA network in the Philippines has only recently started addressing the importance of connecting investment and SME promotion, and hence linkages.

- **A new Magna Carta for SMEs:** The 1991 Magna Carta for MSMEs marked the first major SME legislation in the country, consolidating all SME promotion initiatives into a single institutional framework. Since then, the range of SME promotion activities, both in terms of access to finance and addressing capacity weaknesses in SMEs, has increased substantially. SMEs have varied needs when it comes to assistance in doing business and capacity building, and no single provider can meet all these challenges, often resulting in a proliferation of frequently overlapping measures and activities. This challenge is not unique to the Philippines, but the DTI and other leading agencies are encouraged to further promote clear delineation and complementarity between the various SME promotion initiatives. The laudable achievements of the 1991 Magna Carta are needed again today.

Investment promotion and facilitation in the overall development strategy

The Board of Investments (BOI) was created in 1967 by virtue of Republic Act 5186 to foster and promote industrial development. It was not until 1993, at a time when many countries started setting up investment promotion agencies, that the BOI established an investment promotion group within the agency responsible for promoting investments in the Philippines. Subsequently, the BOI became the first and lead investment promotion agency in the Philippines. It assists both Philippine and foreign investors and also prepares the Investment Priorities Plan (IPP) which lists promoted areas eligible for incentives.

The IPP is primarily guided by the government's blueprint for economic development, the Philippine Development Plan, as well as the President's Social Contract with the Filipino People and the State of the Nation Address, to ensure that it is in line with the government's long-term development goals. The BOI is required by the *Omnibus Investments Code* to consult with other government agencies, the private sector and other stakeholders in preparing the IPP. It identifies sectors to be actively promoted and supported for the current year. In formulating the IPP, the BOI consults concerned government agencies and industry stakeholders through inter-agency consultations and public hearings. Results of these consultations are consolidated by the BOI and submitted to the Office of the President. To ensure that the IPP is in line with long-term goals, it is evaluated yearly and all changes are subject to the approval of the President.

Investment plans formulated by government agencies often run the risk of reflecting political interests and priorities over industry needs and demands, a well-recognised weakness of "picking winners" approaches. While a focused approach to promoting industries, such as through targeted export or SME promotion has its merits, such measures should be short-term and evaluated regularly. They should only be seen as a complement to broader structural reforms to boost the investment climate for inclusive growth, which includes tackling challenges in the educational system and the economy's skillset and improving infrastructure and connectivity.

In 2012, the BOI launched the Industry Development Program through the industry roadmap project. The government has also allocated USD 1.5 million to the Manufacturing Resurgence Program to support the implementation of the Manufacturing Industry Roadmap.[2] This initiative established some basic principles of governance by which the government wishes to approach this new strategy of industrial policymaking and today there are 29 industry roadmaps. The initiative was an important element in strengthening the voice of the private sector in policy design, especially as the IPP was criticised in the past for being heavily government driven (BIR, 2014). The government has also put in place coordination and evaluation frameworks, such as by setting up of industry councils, framed by the following guidelines:

- "What are the growth potentials of the industry in both domestic and export markets? Are there any potential growth areas where the industry might have latent comparative advantage?
- What are the obstacles preventing firms from upgrading the quality of their products? What are the barriers that may be discouraging other firms from entering? Growth diagnostics and value-chain analyses are

applied along with the information and evaluation provided by the industry roadmaps.

- Recommend a policy mix to overcome constraints, manage liberalisation and upgrade the industry. The policy mix will consist of horizontal and vertical interventions as well as coordination mechanisms that would be formulated in order to allow firms and industry to increase competitiveness, latch on to regional production networks, increase capacity to export and enable domestic firms (especially SMEs) to increase their chances of surviving competition." (Aldaba, 2014)

This reform aims to increase private sector participation in policy development processes and can significantly enhance the impact of industry related policies. The roadmaps support industry such as by setting goals and strategies and by identifying specific supply chain gaps and binding constraints that hinder growth. It also clarifies the state's role in supporting industries in crafting and executing the roadmaps. The government focuses on catalysing strategic and tactical initiatives, coordinating government agencies' activities, framing the collaboration with stakeholders and facilitating or brokering constructive relationships (Aldaba, 2014). The government is also strengthening the knowledge triangles between government, business and academia, including research institutions such as the Philippine Institute for Development Studies to support industry creation and development.

Many government-driven investment plans are too broad, aiming to satisfy various interest groups and stakeholders. While inclusive processes in policy formulation are essential, attention should be paid to keeping a strategic focus. In this regard, the 2014 IPP was streamlined to cover 8 preferred investment activities, compared to 13 in 2013. These are now: manufacturing; agribusiness and fishery; services; economic and low-cost housing; hospitals; energy; public infrastructure and logistics; and public-private partnership (PPP) projects.

The 2014 IPP is based on a value chain approach, matching and connecting different poles of competence across the Philippines and has undergone a thorough consultative process. This also follows some lessons learned through the implementation of the Philippine Development Plan 2011-16 including that "growth strategies need to have spatial and sectoral dimensions to ensure inclusivity". Other innovations compared to previous IPPs can be summarised as follows:

- **Purpose**. The 2013 and past IPPs simply listed industries that may qualify for incentives under the *Omnibus Investments Code*. In 2014, the

IPP became a fundamental industrial policy tool for industry development strategies, including sector-specific strategies, analyses of supply chain gaps and the availability of incentives under the OIC.

- **Duration**. The traditional practice was to produce a new list under the IPP every year. The 2014 IPP now has a lifespan of three years to enhance stability, consistency, predictability and certainty in the country's business-related policy environment. Although there will still be an annual review exercise, this now focuses on assessing results. The IPP is now also aligned with the period covered by the PDP.

- **Content**. The 2013 IPP was a list of generic economic activities, specifically, the "preferred areas (13)," "exports," and "mandatory laws (9)." The 2014 IPP clearly aligns with the PDP contents and contains industrial policies, goals, plans and core strategies. It includes profiles on industries and sectors taken from the industry roadmaps. The IPP is now a strategic plan for industrial development, not just or necessarily through incentives, but through other policy measures, reforms and initiatives.

- **Geographical dimension**. The old IPP had a limited geographic coverage, highlighting under-developed areas of the country, such as Mindanao. The new IPP aims to channel investments into least developed areas and will also factor in industry clustering strategies in attracting investments to reflect a value chain approach.

- **Process**. The 2013 and earlier IPPs would typically undergo three public hearings in Luzon, Visayas, and Mindanao, and further inter-agency consultations in the capital, approval by the BOI Board, recommendation to the President for approval, followed by the publication of the draft in a newspaper of general circulation for final comments, 15 days after which the IPP would be considered final. The new IPP underwent an extensive "peer review" of a group of the country's leading economists; numerous inter-agency consultations; several sector or cluster focused consultations; and, four regional consultations. Consultations were also readily open and accessible through the BOI website.

Involving the private sector and other stakeholders in elaborating business-related reforms and policies is good practice, but governments often struggle to do this in an effective manner and to provide ample opportunities to the private sector and other stakeholders to comment and provide inputs. The innovations that were introduced in developing the 2014 IPP have resulted in a better channelling of private sector perceptions in policy elaborations. The inclusive process that underpins the IPP also testifies to the BOI's commitment to enhance its policy advocacy function. A credible commitment to inclusive growth and showcasing capable administration of policies is important to boost and maintain stakeholder confidence in the public system. The BOI also raises awareness about inclusive growth business models through seminars and forums.[3]

With greater industry involvement, the IPP has become more relevant as an investment strategy. The next step should now be to implement the strategy through concrete measures, including well-informed and carefully designed investment targeting and by promoting linkages, all of which are addressed in more detail below. Gradually broadening the stakeholder consultation process even further would also help the government to strengthen its national development plans as well as to enhance strategies for inclusive growth.

Institutional structure for effective promotion and coordination

Governments can adopt a wide array of investment promotion and facilitation structures. Since the 1990s, investment promotion agencies (IPAs) have become a central part of investment promotion strategies (Morisset, 2003). Today, there are over 170 national and 260 subnational IPAs (OECD, 2015b). IPAs can be independent or part of a ministry. In the Philippines, while the BOI under the Department of Trade and Industry is the official national IPA, there are 18 agencies involved in investment promotion, each one with different functions and incentive packages, the most important of which are:

- Board of Investment (BOI)
- Philippine Economic Zone Authority (PEZA)
- Authority of the Free Port Area of Bataan
- Aurora Special Economic Authority
- Bases Conversion and Development Authority
- Clark Development Corporation
- Subic Bay Metropolitan Authority
- Subic Clark Alliance for Development Council (SCAD)
- Cagayan Economic Zone Authority

- PHIVIDEC Industrial Authority
- Philippine Retirement Authority
- Tourism Infrastructure and Enterprise Zone Authority
- Zamboanga Economic Zone Authority
- Philippine Tourism Board
- John Hay Management Corporation
- Mindanao Development Authority
- Poro Point Industrial Corporation
- BOI for Autonomous Region for Muslim Mindanao

Some of these IPAs are intended to channel investment into more remote regions, while others are sector-specific. The Tourism Infrastructure and Enterprise Zone Authority, for example, designates, regulates, and supervises tourism enterprise zones established under RA 9593 and develops and manages tourism infrastructure projects nationwide. It also provides technical and financial assistance to qualified tourism projects and investors.

While there is merit in having different agencies providing tailored services and products to potential and established investors, having so many IPAs poses obvious co-ordination challenges. For example, the different agencies use their own branding and promotional material. Co-ordinating nationwide marketing and promotional efforts is inevitably challenging, but some countries have managed to do so effectively. Chile, for instance, through its Fundacíon de Imagen De Chile has developed a national brand-book which all agencies with the mandate of promoting the image of Chile abroad have to follow.

More strategic challenges relate to ensuring that different agencies effectively implement a national investment promotion strategy as outlined in the IPP without duplication and overlaps of activities and resources. The different incentives packages being offered by the agencies also make it difficult for national authorities to undertake best practice incentives management.

Designated IPAs in the Philippines should have a clear mandate and the capacity to deliver the required functions. Their staff should have private sector experience, their structures should be lean and efficient, and their boards should consist of both public and private sector representatives, which is the case for most IPAs in the Philippines. Many functions of an IPA can be undertaken within existing structures without creating costly additional agencies, resulting in an IPA playing more of a coordinating role, a function that the BOI is taking on increasingly. Generally, most IPAs concentrate on attracting greenfield investment, but promoting re-investments and business expansions can be important, particularly in higher valued-added activities.

One size does not fit all, and different approaches are suitable for different countries and different target enterprises (*e.g.* big and small firms, those in the formal and informal sectors, those run by women and minority groups). Some countries have even contracted out investment prospecting, with mixed results. What is important for investors is to have a single point of contact. In the case of the Philippines and its 18 agencies, this is a challenge.

The organisational, institutional and legal structure of an IPA should be carefully considered, in line with a national investment promotion strategy which determines what exactly needs to be promoted. The experience of IPAs worldwide points to a number of principles that need to be carefully considered with respect to the most effective organisational structure, allowing IPAs to achieve their targets and to fulfil functions effectively. Box 3.1 highlights some good practices in this regard.

The different Philippine IPAs have their individual mandates and most of them enjoy a strong legal status. For example, the *Bases Conversion and Development Act* [RA 7227] created the Bases Conversion and Development Authority and the Subic Bay Metropolitan Authority to adopt, prepare and implement a comprehensive development programme for the conversion of the Clark and Subic military bases into special economic zones. PEZA was created in 1995 through *the Special Economic Zone Act* [RA 7916]. As a result, the various IPAs have different mandates and objectives anchored in a number of legal acts which can create confusion for potential investors and the administration. The government is aware of these challenges and efforts have been underway since 2009, when the PIPP network was created, to synchronise the various IPAs and their activities. This has resulted in joint missions abroad, a common platform, “Invest Philippines”, and a joint website: http://investphilippines.gov.ph.

Box 3.1. Good practices concerning the institutional structure for investment promotion

Successful IPAs are characterised by high political visibility and strong private sector participation. Allowing them to develop strong linkages with public and private stakeholders (*e.g.* utility providers, real estate developers, and consultants) requires a certain degree of autonomy and flexibility. Both public and private stakeholders matter when it comes to promoting and facilitating investment. As such, building relationships with these stakeholders enhances the efficiency of the IPA. In the case of large or high-level investment projects, this network should be exploited to mobilise policymakers and other government officials to improve accountability and certainty for the investor. One single IPA, with a clear mandate, can fully dedicate itself to the task of attracting and facilitating investment.

Political support is essential in overcoming vested interests and in being able to manoeuvre between ministries and local governments whilst simultaneously taking into account the interests of investors. On the other hand, the institutional structure should be protected from short-term political forces that damage the IPA's efficiency. Reporting directly to the President, Prime Minister or other high-level policy-makers as well as to the private sector in a Supervisory Board ensures the most effective advocacy, allowing the IPA to do its FDI attraction job more efficiently. A good practice Supervisory Board or Steering Committee includes representatives from the private sector and is chaired by a senior political leader. Establishing a steering committee is crucial because it strengthens the political commitment and reinforces the IPA's credibility and visibility in the business community as an entity supporting the needs of investors. In other words, it enhances political visibility and private sector involvement whilst showing the overall commitment of the government toward reforms.

It is not unusual for countries to have several agencies promoting investments at national and subnational levels. What is important is for the activities and mandates of these agencies to be clearly outlined and coordinated to avoid wasteful duplication and overlap.

Source: OECD 2015a

The PIPP Steering Committee, with the BOI as technical secretariat, also aims to ensure that the investment promotion efforts of each IPA conform to the PIPP. The PIPP serves as a blueprint for the 17 IPAs, particularly to help develop common approaches to branding. It also covers the list of sectors and activities that may qualify for registration with most IPAs. Moreover, the PIPP Technical Working Group has formed sector specific clusters among the IPA members. Identification of the sectors is based on the specific strengths common to the IPAs. The rationale behind each cluster is envisioned to harmonise and synergise the investment promotion and facilitation efforts of the IPAs, particularly in the areas of tourism, manufacturing/logistics and agri-business. Regular meetings of the Working Group are held to ensure coordination of investment promotion efforts among all IPAs. The PIPP initiative has reaped some results, especially since it regularly achieves its annual investment targets, measured by approved investments.

To further harmonise IPA activities, the IPAs have agreed to share data and information and undertake joint activities. This initiative is taken very seriously by the different IPAs who have pledged financial support on an annual basis to be managed by the BOI. It is happening against the backdrop of reconsideration from the government on establishing new ecozones and a focus on streamlining and harmonising investment promotion across the country. As a result, potential foreign investors in the Philippines will benefit from greater clarity and single points of contact in the short to medium term. For the IPAs, efforts to harmonise investment promotion have also helped in concentrating on fewer sectors and having a better overview of investment statistics collected by the different IPAs.[4]

Many IPAs also have representation in key markets to position the Philippines as an investment destination for potential investors. The Philippines has trade and investment promotion representatives abroad at its 26 Philippine Trade and Investment Centres, including four offices in the US, and five in Europe. Most of these are hosted by Philippine embassies and consulates and considerably add to facilitating investment promotion activities abroad, such as connecting with key potential investors and supporting follow-up at their headquarters.

Investment promotion measures

Effective investment promotion leverages the strong points of a country's investment environment, highlights profitable investment opportunities and helps to identify local partners. IPAs tend to focus on four core functions: image building, lead generation and targeting, investor servicing, and aftercare and policy advocacy. Over time, IPAs refocus their resources and efforts towards the last two functions as a result of increased levels of FDI and maturity of other functions. The main objective of an IPA in its early stages is to draw attention to profitable investment opportunities in the host economy with a focus on image building activities, lead generation and targeting.

Image Building

Image building is about creating the perception of a country as an attractive location for international investment, including through focused advertising and public relations events. This function involves developing a country brand; portraying it through information and sales packages, investment plans in sectors or regions, and policies and incentives for investors and businesses; as well as creating a good website and other communications materials that showcase this brand and the country's investor-friendly environment. Progress and achievements on business-friendliness, as well as global rankings, can be documented and showcased to strengthen the image.

The Invest Philippines website (http://investphilippines.gov.ph/) is informative and clear. It gathers the relevant information from the 17 IPAs, contains general information about the business climate in the country, has links to sectoral opportunities, and information on how to set up a business. Despite significant improvements in harmonising information across sectors and IPAs, the site falls short of being fully comprehensive given the size of the country and the various investment opportunities available, as well as the challenges in streamlining business licensing nationwide

This is particularly true when one examines the links to the potential investment sectors and compares it with other IPA websites. The information varies in detail by sector. For example, the Philippines has a long tradition in attracting export-oriented manufacturing FDI, yet this experience is not displayed beyond a listing of sub-sectors. This contrasts with its links to the shipbuilding sector, which is much more detailed, including elements on skills available and salaries of local workers. Singapore's Economic Development Board's website (www.edb.gov.sg) on the other hand provides highly detailed sectoral information, including contact points and case studies.

Lead Generation and Targeting

Lead generation and targeting consists in actively targeting specific investors in sectors that match economic priorities, national development plans and other criteria. Activities include direct mailing, telephone campaigns, investor forums and seminars and individual presentations to targeted investors. With increased competition for large investment projects between locations and countries, IPAs are increasingly expected to approach investors directly. The outreach and professionalism of the IPA can be decisive in an investment decision. Investment generation activities can be done both at home and overseas. Most large investment decisions are taken at a global or regional level by senior management after long preparation and deliberation. Successful lead generation should bear in mind both counterparts, investors already present in the country and at headquarters level. The latter can also be addressed through IPAs' representations overseas.

Each IPA in the Philippines has its own strategy to target investors, while Foreign Trade Service Corps officers at the Philippine Trade and Investment Centres also conduct market intelligence to target companies that can be invited to explore opportunities in the Philippines. Clark Development Corporation, for example, has identified its preferred investment in line with the PDP, which its promotion efforts are focused on. Consistent with its mandate to generate investments and employment, this list includes labour and export intensive industries. At present, Clark Special Economic Zone/Clark Freeport Zone is being promoted as an emerging electronics, manufacturing and ICT hub with a view to develop an integrated supply chain for electronics and manufacturing in the zone. The Authority of the Freeport Area of Bataan uses the PIPP as its reference for investment targeting, while the Aurora Pacific Economic Zone and Freeport Authority concentrates its marketing efforts on agro-industrial production and processing, aquaculture, ecotourism, and renewable energy.

To implement its subnational investment promotion strategy, the BOI through the Domestic Investments Promotion Service regularly undertakes capacity building activities on investment promotion for the LGUs based on their competitiveness ranking of the National Competitiveness Council at the city and the provincial levels.

Investor Servicing and Facilitation

A core mandate of investment facilitation includes filling an information gap created by incoherent policies, providing investors with much needed clarity and security vis-à-vis public administration. Effective one-stop-shops with single-point authority can be a critical factor in investment decisions, especially if they lower the investor's cost of market entry. Investor servicing and facilitation can include activities such as information provision, "one-stop-shop" services to expedite the approval process instead of sending investors to all the different agencies and ministries in charge of licences, permits and approvals, and various forms of assistance , such as in obtaining sites and utilities. IPAs can provide advice on the required steps, documents and paperwork, and put investors in contact or help co-ordinate with the various actors involved in clearing administrative steps and approvals.

The Philippines has a number of good examples of one-stop-shops, offering particularly effective services to investors, such as PEZA, CDC and the BOI One-Stop Action Center. PEZA is recognised internationally for its one-stop-non-stop shop, providing a 24 hours, 7 days a week service to investors. The services it offers under one roof include issuing building and occupancy permits, import and export permits, online procedures including e-payment systems, environmental clearance certificates, fast processing of food and medical devices, and special multiple-entry non-immigrant visas. PEZA's processing is recognised as fast and straightforward (CIE, 2008).

Since 2013, Clark Development Corporation has started streamlining administrative procedures on all frontline offices offering services such as permit processing. Based on official data for 2013, it has reduced processing time on average by 48%. As the Chair of the PIPP, the Bases Conversion and Development Authority has initiated a programme called the harmonised Business Start Up and Registration System (eZ-Biz system). The goals of the system are as follows:

- To facilitate entry of foreign direct investments by introducing a speedy, uniform and standard process of doing business;
- To achieve a unified, streamlined, cost-effective, automated and interlinked business registration, trade facilitation and information process;
- To maximise the use of the country's marketing resources and at the same time create a focused promotional approach to the international business community;
- To have the fastest business start-up and registration system in the country.

Clark Development Corporation is in the later stages of developing and testing of the EzBiz System in close coordination with the Bases Conversion and Development Authority (BCDA) and the Subic Clark Alliance for Development (SCAD). It will eventually be rolled out to all BCDA subsidiaries and finally if successful to all IPAs. This system allows for an online interface and a real time business inquiry and registration system that would allow prospective investors seamless inquiries. This will also build on SCAD's achievements in improving the processing of immigration documentation in Subic and Clark (Table 3.1).[5]

Table 3.1. **Improving Subic-Clark Immigration System**

Item	Before	Present
Documents required	Average 12	Average 4
Processing time	Average 7 days	Average 2 days
Cost	Average USD 150	Average USD 75
Offices involved	4 Offices	1 Office (one-stop-shop)
I-Card issuance	Manual processing	Automated processing

Source: SCAD (2014)

When conceptualising and implementing the eZ-Biz project, BCDA was inspired by the good practices of Hong Kong, China; and Singapore. Also, as Subic Bay Metropolitan Authority and Clark Development Corporation have an existing agreement with the Export Processing Zone in Chinese Taipei relative to the harmonisation of the immigration, customs and quarantine systems in the economic zones, BCDA looked at its old systems and harmonised, streamlined and automated the system to conform with world standards.

The SBMA has created a one-stop-shop for locators for efficient processing of import and export documents and release of shipments within one to two hours. It continues to spearhead streamlining procedures to make the arrival of goods and shipping out of finished products in the Port of Subic Bay more cost effective and faster. This has attracted more companies to invest in Subic Bay Freeport and significantly increased the handling of container volume from 37 000 in 2013 to 120 000 TEUs[6] in 2015. With this key development and EO 172 signed by President Aquino, which makes Subic an extension port of Manila, the Port of Subic Bay will play a pivotal role as a logistics and trans-shipment hub in Central Luzon and the country as whole.

Effective investment facilitation often requires an IPA either to host its own one-stop-shop or to be able to coordinate the different services that are provided by partner agencies. Investors looking to establish themselves in a new location are faced with a multitude of administrative procedures relating to registering and opening a business. From visas to licences, clearances, permits and registration with tax authorities, investors must typically interact with and obtain documents and approvals from government agencies across the board before starting a project.

These steps easily become costly and time-consuming and can constitute significant investor irritants. Many governments have thus considered the concept of "one-stop-shops" for investors, uniting all administrative procedures in one organisation. This can prove a difficult task, as it requires the agency in question to concentrate relevant expertise and authority for these procedures or to coordinate effectively between different government bodies and departments that may have very different procedures and requirements. Even where the one-stop-shop has a mandate of coordination only, this may lead to conflicts of competencies and turn the one-stop-shop into an additional step in the process.

Setting up a business in the Philippines can be complex. It ranks 165 out of 189 in setting up a business under the World Bank's *Doing Business* indicators (World Bank, 2015). This is a particularly challenging situation for SMEs who cannot afford the services of professional advisors and legal experts. This is made even more challenging because of the role of LGUs with significant independence in their jurisdiction, while, in some cases, coupled with capacity and resource constraints. In such circumstances, competent facilitation services are critical to help investors navigate the myriad steps to set up a business in the country. The successes of PEZA and CDC in streamlining business-related procedures provide evidence of how doing business in the Philippines could be improved beyond ecozones.

Beyond what some of the ecozones are doing to assist investors, the government is also facilitating business registration. The BOI has launched the BOI-One Window Network project to serve as a centralised databank for investments-related information, allowing the facilitation of investors issues and concerns online. The system provides real-time notification on status of the query/concerns raised. The BOI's Investments Assistance Center offers frontline services and assistance to expedite setting up a business. Personnel from several government agencies are on call to answer investors' inquiries and to register businesses.[7] The Center offers a wide range of services, as well as counselling. To enhance facilitation of issues and concerns raised by investors, the BOI has also signed a memorandum of agreement involving many departments[8] and is negotiating with several more departments and agencies.[9] Other recent efforts were undertaken to streamline administrative procedures to speed up and reduce the cost of investing and doing business in the Philippines which include:

- The Philippines Business Registry: a government-initiated project that facilitates business registration-related transactions by integrating all agencies[10] involved in business registration thus providing a faster process for business registration, thus strengthening the government's effort to provide quality service and aimed at curbing corruption and reducing red tape in the bureaucracy. It is web-based and serves as a one-stop shop for entrepreneurs who need to transact with several agencies to be able to start operating a business. Each of the agencies' computerised registration systems will be interlinked so that applicants need not physically go to each agency to register their businesses.

- The Business Permit and Licensing System aims to reduce the cost of doing business through the adoption of one form and reduced steps, days, and signatories for new applications and business renewals resulting in a more efficient business environment both at the LGU and national levels.

- BOI's extension offices in the regions and provinces such in Visayas and Mindanao, which undertake significant investment promotion, investment counselling, leads generation, investor servicing and aftercare services.

These efforts are critical as the Philippines struggles to improve in key areas of doing business. The pro-active approach and successes in terms of business facilitation in some of the ecozones, like in PEZA and CDC, could serve as a blueprint for nationwide streamlining of procedures for setting up a business. Investor feedback points to a key advantage of being located in some ecozones: having to deal only with the zone management instead of with the LGUs. While this seems like an effective arrangement for some investors, it is not sustainable and inhibits the development of domestic industry outside the ecozones. This potentially jeopardises the government's inclusive growth agenda, which relies on local enterprise creation and growth. Ecozones are discussed in more detail further below.

A government handbook on *Streamlining Business Registration in LGUs* contains good practices in issuing business permits and licences found in 16 LGUs all over the country. It is intended primarily for local chief executives and LGU officers in charge of issuing business permits and licences. The government also prepared a toolkit on *Simplifying Business Permit and Licensing Process of Local Governments* which offers a simple, easy-to-follow, step-by-step procedure on how business permit and licensing system at the LGU level can be improved. It features experiences, good practices, lessons learned and helpful tips shared by other LGUs.

Aftercare and Policy Advocacy

Aftercare comprises all potential services offered at the company level by governments and their agencies, designed to facilitate both the successful start-up and the continuing development of a foreign affiliate in a host country or region so as to maximise its contribution to local economic development. IPAs are increasingly aware of the need for continuing support to investors beyond the initial establishment of a project, given the potentially high impact it has on retaining investors and encouraging reinvestments. Reinvestment by existing investors accounts for a major share of FDI, so the services provided to existing investors can critically contribute to decisions on investment destinations. Keeping existing investors satisfied and convincing them to reinvest is less costly and complex than attracting new ones. Many countries have struggled to retain investors after an investment peak. Satisfied IPA customers can enhance an IPA's promotional activities and help convince other investors consider a given investment destination.

The IPA may act as an entity within the government to seek necessary approvals or urge the removal of obstacles to investors, thereby improving regulatory transparency and act as a conduit for foreign investors to policymaking. As such, there is a close link between aftercare and policy advocacy. Policy advocacy includes efforts to modify regulations, laws, government policies and their administration, pertaining to fields that directly affect the investment climate such as investment, trade, labour, immigration, real estate, taxes, infrastructure, technology and education. Through enhancing dialogue and policy review with relevant stakeholders, policy advocacy can effectively reform the investment climate and promote policies that ultimately enhance private investment's impact on the economy.

The most effective IPAs devote substantial resources to policy advocacy and to resolving investor complaints. Box 3.2 highlights Canadian and British approaches.

In 2008, BOI reorganised its structure to focus more on investment promotion by providing information assistance and investment facilitation of investors' transactions, investment advice, investment matching and business linkages services. This has resulted in an aftercare programme, implemented by the BOI's Investment Assistance and Services Department, to engage directly with BOI-registered investors, rather than waiting for investors to seek assistance. In 2015, further rationalisation of BOI's activities and functions led to the merging of the Investment Assistance and Services Department with the former BOI One Stop Action Center to create additional synergies under a new Investments Assistance Service (IAS).

Box 3.2. **Aftercare in Canada and the United Kingdom**

Invest in Canada's aftercare programme

Invest in Canada's aftercare programme regularly follows up with investors throughout the duration of their investment projects. The Department of Foreign Affairs' Trade and Development network of investment officers overseas undertakes regular 'back-to-back outcalls' to targeted investors, to discuss project status and needs for other services and support. These often involve an ambassadorial level meeting at investor headquarters, and an Invest in Canada or regional IPA meeting with the CEO and top management of the investors' local subsidiaries. These visits allow Invest in Canada to maintain dialogue and a good relationship with established investors at both the operational level, where investors deal with operational and administrative hurdles, and at the headquarters level, where larger investment/reinvestment decisions are often made. They also help detect investor irritants, which may become potential obstacles to reinvestment.

UK Trade and Investment's key account management

UK Trade and Investment has set up a key account management system to target companies that have been identified as important for economic growth. It builds relationships and exchange with different branches and agencies of government to be able to consider the priorities and needs of major investors. Strategic relationship management techniques are used to understand better the operations of the target company and to establish common, long-term strategies vis-à-vis major investors to promote positive economic benefits. To coordinate the relationship and to improve the communication between investors and government, major companies are provided with dedicated account teams that are tasked with responding to investor queries, providing information about government services, and coordinating the contact with relevant government departments.

Source: UKTI (2014), Annual Report and Accounts 2013-2014, Invest in Canada (2014)

Central to its implementation is the Investment Promotions Unit (IPU) Network, a collaboration of 28 government agencies to resolve quickly the difficulties encountered by investors. The BOI acts as the secretariat to dispatch and monitor cases and tracks progress in resolving the issues. To continuously improve the aftercare services, a Client Feedback Mechanism Form was introduced. The BOI also implements the Retention Expansion Diversification Program to encourage existing investors to retain, expand or diversify their operations in the country. The RED initiative is under the Strategic Investors' Aftercare Program of IAS, geared towards improving aftercare services to existing locators to further enhance investments in the country.

To improve the communication channels within the private sector and improve investor confidence, an Investment Ombudsman was created to act on investment-related complaints involving violations of commitments of IPU member agencies. The power and functions of the Investment Ombudsman are grievance-handling or public assistance and fact-finding. The Investment Ombudsman Team considers trade and investment-related concerns of an investor or potential investor in the following area: *i*) delays in the delivery of frontline services relating to the establishment or conduct of business; *ii*) issuance of business licences, permits and certificates to any person not qualified or legally entitled; *iii*) solicitation, demand or request by a government official in exchange for issuing licences, permits and certificates, the release of shipments and cargoes, as well as the arbitrary assessment of fees for the conduct of business; and *iv*) any other delay or refusal to comply with the referral or directive of the Investment Ombudsman Team.

The *Local Government Code* (RA 7042) was introduced in 1991 to decentralise investment promotion. It stipulates that “the territorial and political subdivisions of the State shall enjoy genuine and meaningful local autonomy to enable them to attain their fullest development as self-reliant communities and make them more effective partners in the attainment of national goals”. LGUs face significant challenges in effective investment promotion and facilitation, linked to capacity constraints. To some degree, their autonomy can also contribute to co-ordination difficulties, especially in implementing national development objectives. In practice, this has resulted in a large share of investment going to special economic zones managed by PEZA. According to some investors, one advantage of PEZA zones (backed by the *Special Economic Zone Act*) is that investors do not have to deal with LGUs for registration, land issues, and operations (including imports and exports). The government is aware of these challenges and provides capacity building for LGUs on investment promotion.

Box 3.3. **Main measures supporting investment promotion in the Philippines**

- Omnibus Investments Code of 1987 (EO 226, as amended) simplified and consolidated previous investment laws.
- Foreign Investments Act (RA 7042) to accelerate the FDI liberalisation process
- Local Government Code (RA 7160) decentralises the administration of investment laws by granting more investment regulatory control to local government units
- Creation of Special Economic and Freeport Zones (see the section on SEZs below)
- Creation of the Investment Promotions Group in the BOI in 1993
- Formulation of the Philippine Investments Promotion Plan (PIPP) and establishment of the PIPP Steering Committee composed all Investment Promotion Agencies to harmonise investment promotions efforts of the country.
- Countrywide capacity building of LGUs on investments promotion

Source: Board of Investments (2014)

Monitoring and evaluating investment promotion

Appropriate performance monitoring and evaluation helps IPAs to improve their impact and efficiency. Key performance indicators (KPIs) typically include the number and amount of new investment projects (committed or completed) for a given year, investment leads, as well as the number of jobs created and safeguarded. Some IPAs also use activity indicators to monitor the activities in a given period.

Some ASEAN IPAs have developed thorough monitoring and evaluation systems, such as through the use of KPIs. The Malaysian Investment Development Authority, for example, has also developed a Client Charter to monitor the agency’s responsiveness and professionalism in addressing investors’ enquiries, information provision and project implementation assistance (OECD, 2013b). Ideally KPIs should go beyond these to measure and monitor exactly what activities of the IPA have contributed to what type of investment. This also protects the IPA from expectations to deliver beyond its mandate (Box 3.4).

Box 3.4. **IDA Ireland's Key Performance Indicators**

IDA Ireland

IDA Ireland, the Irish investment promotion agency, has created a broad and sophisticated set of indicators on agency performance, assessing the impact of investment on national economic and development objectives. KPIs go beyond IPA activities to reflect the agency's strategic objectives as outlined in *Horizon 2020*: *IDA Ireland Strategy* (2010):

- Continue to attract suitable, high quality, knowledge and skills-based FDI;
- Place Ireland at the leading edge of the global economy in specific niches;
- Achieve a better, more equitable regional balance in investment across Ireland. To mobilise regions rather than localities to compete actively with regions internationally;
- Develop clusters of excellence in which a range of companies and R&D centres operate to create a climate of innovation and entrepreneurship;
- Work with current inward investors to move up the value chain and utilise the ever-expanding skills base of the Irish workforce; and
- To encourage companies to move towards more advanced technological processes with a greater focus on R&D. To influence improvements in infrastructure and skills.

Accordingly, its KPIs take into account the total number of investments; R&D and innovation; and the share of investment and jobs outside the main urban areas of Dublin and Cork. IDA Ireland seeks to attract investment requiring skilled, well-paid employees, and has developed indicators to measure the average salary of jobs created. It monitors the direct economic impact of its client companies, including through the generation of exports, total direct expenditure in the Irish economy, and annual corporate tax payments.

IDA Ireland indicators

- Total number of investments approved
- Number of greenfield projects
- Number of expansion projects
- Number of research, development and innovation projects
- Investment in research, development and innovation projects
- Percentage of investments located outside Dublin and Cork
- Percentage of jobs approved outside Dublin and Cork
- Percentage of jobs approved with salaries in excess of EUR 35 000
- Average salary in new investments
- Annual corporate tax payments of IDA client companies
- Total R&D in-house expenditure

Source: IDA Ireland (2014), Annual Report and Accounts 2013, Dublin; IDA Ireland (2010), Horizon 2020: IDA Ireland Strategy.

The BOI has its own Citizen's Charter which can increase its accountability vis-à-vis citizens or clients. It can also be used to codify in one document all relevant information for investors, including benchmarks on time taken to complete administrative processes. Such charters should remain practical and easy to use. The BOI's Citizen's Charter is helpful in codifying processes, but could include more practical information on timeframes and should be more of a client's guide, rather than being a legalistic instrument.

The performance of the BOI in terms of attracting investments is reviewed on an annual basis. The Office of the President through the Department of Budget and Management also annually monitors the "Major Final Outputs" and "Programs, Activities and Projects" committed to be accomplished by the BOI. The performance in terms of attracting investment is regularly reviewed. Investments are monitored by capturing committed investments on contracts awarded by respective IPAs. Other indicators used to monitor performance of the agencies include the number of projects signed per year, investments generated from new projects and business expansions, employment generation, and export statistics. The BOI also monitors the investment generation figures in the LGUs. The BOI has also taken measures to improve the monitoring of its own activities through the Performance Governance System introduced in 2013 through a results-based system that harmonises individual and organisational performance.[11] For better monitoring of investments, IPAs continuously undergo training on investment data collection done by the Philippine Statistics Authority.

Internationally recognised certifications, such as ISO certifications, can also greatly help in enhancing an agency's performance and regular monitoring linked with maintaining the certification. Among the member IPAs, only PEZA and the Subic Bay Metropolitan Authority are ISO Certified. Clark Development Corporation is currently in the process of establishing a Quality Management System aligned to ISO 9001:2015. The BOI and the Tourism Infrastructure and Enterprise Zone Authority are in the process of being ISO Certified.

The incentives regime

Despite evidence of only a limited investment response to a lower tax burden relative to revenue forgone, tax incentives are routinely used by governments to attract investment in general, and foreign direct investment in particular. The rationale behind this widespread practice is that it is much easier to provide tax incentives than to correct deficiencies in, for example, infrastructure or skilled labour. IPAs and revenue collection agencies often have shared responsibilities, but are often working towards different objectives. Policy makers should take a holistic view of their country's tax rates and tax mix to balance the country's broad range of social and development objectives against the need to attract investment (OECD, 2015b).

While IPAs feel compelled to offer tax incentives in order to attract investors, tax policymakers and revenue collection agencies argue that revenues are needed to provide public goods, including the key pillars of a business-enabling environment, such as infrastructure and a healthy and educated workforce. Tax policymakers should coordinate with various authorities mandated to promote investment, including at local government levels. Countries that have been successful in designing tax policy attractive to investment have generally adopted a whole-of-government approach to ensure consistency between the country's tax policy, its broader national and sub-national development objectives and its overall investment attraction strategy.

Investment incentives available in the Philippines are similar to those offered elsewhere in the region. A Philippine national enterprise may register its activity with the BOI provided that its project is listed as a preferred area in the current IPP. Domestic private investors enjoy lower threshold in terms of export commitment as follows:

- At least 50% of production is for export (for enterprises with Filipino ownership exceeding 60%); or
- At least 70% of production is for export (for more than 40% foreign-owned enterprises)

To access the various incentives, investors need to register with the respective IPA. The same incentives are available to both foreign and domestic enterprises, which is good practice (CIE, 2008). Spreading economic activities to less developed areas is also highly encouraged by the government through pioneer incentives (6 years tax holiday) and additional deductions from taxable income equivalent to 100% of expenses incurred in developing necessary and major infrastructure facilities, but the impact of these should be closely monitored and time-bound. If incentives are so highly geared towards prompting firms to locate production in places where it would not otherwise make commercial sense, then it will be very difficult to withdraw the incentives without triggering exit. If incentives are offered, the aim should be to jump-start development of activities that can and will become self-sustaining in a given place within a reasonable time frame.

Table 3.2. **Dualistic incentives regime in the Philippines**

Omnibus Investments Code (EO 226), Board of Investments	Special Economic Zone Act (RA 7916, as amended by RA 8748) Philippine Economic Zone Authority
Access to Bonded Manufacturing/Trading Warehouse System	Separate Customs Territory/Tax Treatment of Merchandise
Modified Rates of Duty on Imported Capital Equipment	Tax and Duty Free Imports of Capital Equipment
	Tax and Duty Free Imports of Construction Materials
	Tax and Duty Free Imports of Specialised Office Equipment & Furniture
	Tax and Duty Free Imports of Specialised Vehicles & Other Transport Equipment
	Tax and Duty Free Imports of Professional Instruments & household Effects
Income Tax Holiday	Income Tax Holiday
	Preferential Tax Rate of 5% on Gross Income Earned, in lieu of all taxes
Tax Credit on Domestic Capital Equipment and Raw Materials	Tax Credit for Import Substitution of Raw Materials, Capital Equipment and/or Spare Parts
Unrestricted Use of Consigned Equipment	Unrestricted Use of Consigned Equipment
Additional Deduction for Labour Expense	Additional Deduction for Labour and Training Expense
Exemption from Contractor's Tax	Exemption from Contractor's Tax
Exemption from Wharfage Dues, Export Tax, Duty, Impost or Fee	Exemption from Wharfage Dues, Export Tax, Duty, Impost or Fee
Simplification of Customs Procedure	Simplification of Customs Procedure
Employment of Foreign Nationals	Employment of Foreign Nationals
Multiple-entry visas for expatriates, including spouse and unmarried children below 21 years old	Immigration/Visa Processing for Foreign Investors
Exemption from securing Alien Certificate of Registration	
Long-Term Lease of Lands and Buildings	Long-Term Lease of Lands and Buildings
	After tax profits remittance without prior BSP approval

Most investment incentives are legislated under the *Omnibus Investment Code*, with the *Special Economic Zone Act* 1995 available to businesses locating in SEZs. This dualistic incentives regime is summarised in Table 3.2. Having many laws covering the incentives regime contributes to a complex policy landscape lacking transparency (CIE, 2008). The BOI also offers specific incentives for regional headquarters and regional operating headquarters. The different IPAs administer their respective incentives laws, each promoting their investment initiatives and objectives, albeit within the framework of the agreed IPP. While the Department of Finance participates in the elaboration of the IPP, the revenue authorities have only a very limited involvement in the tax policy decision (BIR, 2014). This is suboptimal in light of the government's efforts to maximise domestic resources. International experience suggests having tax administration bodies handling incentives, not least because IPAs face capacity and resource constraints in handling tax matters.

One of the concerns over the use of incentives is the resulting forgone revenue.[12] One could argue that this can in principle be balanced out by the investment these incentives have generated, as well as its positive spillovers through technology and knowledge transfer. In the Philippines, complete data on the cost of incentives has not been publicly available, and there has been no reporting mechanism on the cost and the benefits directly attributable to the amount of incentives being given away (BIR, 2014). The recently enacted *Tax Incentives Management and Transparency Act* will help to increase transparency on the cost of incentives against the estimated benefits. Cost benefit analysis is a key component of effective incentive administration (Box 3.5).

Each IPA is responsible for administering incentives within its jurisdiction. For the BOI, for example, "benefits" are the investors' contributions to the economy by virtue of their operations in the country, including capital investment, jobs created and export earnings. These are monitored through the submission of annual reports of operations which all BOI-registered enterprises are required to file and are compared with the firms' audited financial statements, employee master lists, and inward remittance certificates from banks to ensure accuracy.

Policy makers should regularly assess the tax burden on profits to determine if the tax system is conducive to the type of investment the country seeks to attract. The main statutory provisions as well as the effects of tax-planning strategies increasingly used by businesses to lower the tax burden should be taken into account, along with compliance costs from excessive complexity and a lack of transparency and predictability in the tax system. If the tax burden on business income is judged to be inappropriate, either too high to attract and retain investment or too low in relation to the country's revenue needs, consideration should be given to adjusting the statutory tax parameters. To address these issues, several proposed bills from both Houses of Congress are now being scrutinised to address transparency and accountability of investment incentives.

Box 3.5. **Evaluating costs and benefits of investment incentives**

If a tax incentive programme is to contribute to a country's economic welfare, its benefits should exceed its costs. It is therefore, important that decision makers have a capacity to distinguish between beneficial and wasteful tax incentives programmes. As such, thorough analysis of the effectiveness and cost-efficiency of proposed tax incentives should be conducted both prior to introducing investment-promotion measures as well as systematically ex-post, to assess the extent to which, and the cost at which tax incentives meet their intended objectives.

An evaluation of the economic ***benefits*** of tax incentives should take into account (a) direct impact by the incentives-motivated investment; (b) indirect and induced impact due to–inter-industry transactions and changes in income and consumption; (c) positive externalities, such as technology and know-how transfers by incentives-induced FDI; and (d) social and environmental benefits where tax incentives serve to correct market imperfections. The ***costs*** that should be considered when conducting a cost-benefit analysis of a given tax incentives programme include; (a) primary revenue forgone due to tax incentives; (b) revenue leakages due to unintended and unforeseen tax-planning opportunities; (c) costs incurred by taxpayers in order to comply with a given tax incentives regime; (d) the administrative costs from running the tax incentives programmes due to the complexity introduced to the legislative and regulatory framework; and (e) the costs to the economy of creating an "uneven playing field" where domestic firms are not entitled to the same tax incentives as their foreign competitors.

Source: OECD Policy Framework for Investment (2015).

Despite the effective business facilitation and support measures in the ecozones in the Philippines as seen further below, these rely heavily on incentives to attract investors. International experience has shown that while successful zones provide quality infrastructure and a good environment for doing business, they do not always require very highly geared fiscal incentives. According to a survey of zone investors in ten countries in 2009, levels of corporate taxation ranked fifth among their concerns, behind cost/quality of utilities, access to transport infrastructure, regulatory environment for business and trade facilitation (Farole, 2011). For example, Charitar and Narrainen (2009) point to the success of the Shenzhen High-Tech Industrial Park, which attracted some 2000 firms while offering only very limited fiscal benefits.

The government recognises the need to streamline the institutional framework for granting tax incentives and to avoid redundancy. The improved processes in formulating the IPP add focus to the incentives allocation, but a fundamental shift in the Philippines' approach of multiple laws, regulations and agencies governing national resource mobilisation through taxes needs to be undertaken in line with international good practice. The *OECD Checklist on Foreign Direct Investment Incentives Policies* can provide useful guidance in this regard.[13]

The central role of economic zones in the Philippines

Many governments worldwide have opted for economic zones to attract investors, create jobs and increase export earnings. Today there are over 1 700 zones ranging from pure export-processing zones, to industrial parks and sharing features such as a geographically defined area, streamlined procedures – such as for customs, special regulations, tax holidays – which are often governed by a single administrative authority.

The Philippines hosts well over 300 economic zones, commonly referred to as ecozones. FDI in these zones accounted for a quarter of total FDI in the 1980s and 78% of its total exports in 2005 (Farole, 2011). The Philippines Economic Zone Authority (PEZA) alone owns three ecozones and administers the incentives for over 300 zones which are privately managed. These include 21 agro-industrial economic zones, 216 IT parks and centres, 64 manufacturing economic zones, 19 tourism economic zones, and two medical tourism zones (as of May 2015). Other major zones include Subic Bay Metropolitan Authority and Clark Development Corporation, which all form part of the country's network of IPAs (OECD, 2014a).

The first ecozone in the Philippines, the Bataan Export Processing Zone, was established in 1969 as part of the government's efforts to boost exports. Other ecozones soon followed with a common set of objectives to promote exports, create employment, and attract investment, including FDI (Manasan, 2013). The *Special Economic Zone Act* of 1995 (RA 7916) replaced this traditional zone model by creating PEZA to manage and operate government-owned zones and administer incentives to other ecozones (BOI, 2014). Section 3 (c) of the Act specifically mentions the ecozones purpose and objective "to promote the flow of investors, both foreign and local, into special economic zones which would generate employment opportunities and establish backward and forward linkages among industries in and around the economic zones…"[14]

Box 3.6. **Good practices in Special Economic Zones**

- Foreign/local ownership: No limitations, equal treatment
- Catering to the domestic market: Liberalised, criteria based, subject to regular, non-zone based import regulations
- Purchases from the domestic market: Companies eligible for exporter benefits since these should be treated as exports from domestic markets
- Eligibility for benefits: No minimum export requirements, foreign and domestic companies, private zone developers, manufacturers and service providers
- Labour and environmental policies: Full consistency with international norms, including ILO labour standards and OECD MNE Guidelines, and with national legislation, monitoring office in the zone
- Private zone development: Competition with government managed zones on a level-playing field, developers eligible for full benefits, clearly defined in legislation, including criteria
- Enhancing GVC integration: Training facilities for local staff and companies in the zones, policies to develop clusters around the zones that cater companies located in the zones

Source: OECD (2014b).

The Act also specifically encourages private zone developers and operators, resulting in a large number of privately managed ecozones under PEZA, with the latter managing the incentives. Getting the private sector involved in zone management is good practice. PEZA also encourages domestic enterprises and zone developers with dedicated incentives, including exemption from all national and local taxes in lieu of a special rate of 5% on gross income, VAT exemption on local purchases, exemption from expanded withholding tax, and deductions for training expenses. As of 2014, PEZA zones had 2 823 domestic firms and 2 303 foreign MNEs.[15]

While their impact on broad-based and inclusive growth is open for debate, these zones have undoubtedly contributed to attracting export-oriented FDI and boosting manufacturing activity. The PEZA zones' share of total manufactured exports of the country increased from 68% in 2001 to 87% by 2009 (Manasan, 2013). Some of the zones also boast good business frameworks, as described earlier. The Clark Development Corporation has a corporate social responsibility unit onsite which promotes responsible business in the zone. Every PEZA zone also has a PEZA staffed monitoring office which makes sure the zone developers and locators comply with national social and environmental legislation.[16] Some studies even cite PEZA zones as a "shining example of successful regulatory reform" (Akinci, 2006). Generally, in the Philippines, ecozones are underpinned by a solid legal status and clear mandates.

Other ecozones in the Philippines besides PEZA also provide a good business environment for investors, such as the former US bases, which were converted into ecozones following the *Bases Conversion and Development Act* of 1992. The Bases Conversion and Development Authority (BCDA), a corporation under the office of the President, oversees Subic Base Metropolitan Authority and manages a number of zones. BCDA also built the 94 kilometre Subic-Clark Tarlac Express Way to link the former airbase of Clark with Subic which has a seaport, reducing transit time between the two zones by 75%.[17]

CDC has seen an increase in locators from 294 in 2003 to 717 in 2014 and by January 2014, CDC had registered USD 4.5 billion worth of investment, mostly in the industrial, services and commercial sectors. The majority of the locators are domestic investors, followed by Japanese and Korean investors. In terms of impact, these investments generated 72 616 jobs by 2013. Table 3.3 highlights the investment and employment created by major US companies located in Clark. Exports have also almost quadrupled over the past 3 years to USD 4.8 billion.

Table 3.3. **Top US companies in Clark**

Company	Actual investment (USD million)	Employment
Texas Instruments	2 000	3 000+
Viskase	14.8	108
NCO	7.3	1 134
UPS	7.2	728
Cyber City Teleservices	3.9	1 306
S-Corp Philippines	1.8	581
IQOR	1.3	2 818
Peregrine	0.9	178
API Asia	0.5	19

Source: CDC (2014).

The zone has improved its electronic business registration, allowing businesses to complete their transactions online. CDC management also introduced a three-year certificate of registration, to save businesses the trouble of renewing their permits every year, which contributed to reducing processing time by 30-50%. For these initiatives, CDC received international recognition in 2014 and acts an example for reducing red tape and for improving business-related procedures (Headline, 2014).

The Subic Bay Metropolitan Authority is one of the leading IPAs in the Philippines, with 1 538 registered companies as of 2015 with USD 10 billion of investments and almost 100 000 workers employed. The biggest locator is Hanjin with USD 2 billion invested and employing 33 200 skilled workers. The SBMA was the overall winner for Asia in 2015 of the fDi Global Free Zones Award, owing in part to its performance in encouraging reinvestment.[18] In 2014, the SBMA contributed PhP17.8 billion to the national economy in taxes, LGU shares from gross income earned and dividends, a 38% increase over 2013.

According to the Subic Bay Metropolitan Authority (SBMA) rules and regulations, the Board of Directors of the SBMA is composed of 15 members, appointed by the President of the Philippines, including "representatives of all local government units that concur to be part of the Subic Bay Freeport; two representatives from the national government; and five representatives from the private sector." Such strong involvement of the private sector in the oversight of the zone's activity is good practice, also for any investment promotion agency as mentioned earlier (OECD 2014a).

SBMA fully applies national laws with regards to labour rights and environmental protection, according to its rules and regulations. It has also created an Ecology Centre entrusted with functions linked to environmental management, including monitoring, training and permitting. According to its rules and regulations, it also requires enterprises in its free port to "install adequate environmental protection facilities and pollution control systems…", and "recognises the importance of maintaining a high degree of environmental quality as a precursor to sustainable economic development of the areas both under and adjacent to its jurisdiction..." SBMA also reserves a certain proportion of its land for environmental conservation.

As regards labour rights, the SBMA established a labour centre, "responsible for studying and amicably settling professional and labour relations and disputes, interpretation of employment contracts, and monitoring work hygiene and safety standards..." (SBMA, 2015).

In order to ensure decent handling of labour disputes in PEZA zones, the Philippines Department of Labor and Employment (DOLE), the Philippines National Police, and PEZA launched the Joint DOLE-PNP-PEZA

Guidelines. DOLE has sole and exclusive jurisdiction in resolving labour disputes, including the zones. Workers in the economic zones can also exercise their right to self-organisation and collective bargaining and they are allowed to join, form or assist in forming unions and organisations inside the zones (see the chapter on responsible business conduct).[19]

Building capacity and upgrading skills within ecozones is a good but rare practice. A number of good Philippine examples, both in terms of regulation and in implementation, include requirements for training anchored in ecozone regulations which require foreign nationals performing supervisory, technical or advisory functions to train Filipinos in each area of responsibility.

Encouraging training through regulation is not enough, and pro-active worker training and capacity building of small suppliers should be part of any competitiveness scheme in ecozones. Using the private sector in developing the training curriculum ensures that it addresses industry needs and contributes positively to developing linkages between local suppliers and larger companies, including MNEs. In this regard, SBMA regularly organises training and skills-upgrading programmes, often in partnership with agencies like the Development Academy of the Philippines and companies.[20] CDC also recently signed an agreement with the Philippines' Technical Education and Skills Development Agency to increase the skills of workers in Clark and surrounding areas, including in Central Luzon by establishing a joint Technical-Vocational Training Centre at Clark Polytechnic, a former training facility for aviation and maritime students.[21] See Box 3.7 for capacity building initiatives available to SMEs or further below for a more elaborate treatment of SME promotion.

If zones are to contribute over the long term to strengthening the economy as a whole, then they must be designed to engage deeply with the local economy around them rather than developing as enclaves. To address this risk, zone-based strategies should consider measures such as extending indirect exporter benefits (*i.e.* duty free access) to local firms that supply zone residents. Collaborative relationships should also be encouraged between investment projects in the zones and local firms/research institutions economy (OECD 2009). Overall, conditions governing zones should favour their integration with the domestic economy, including the transfer of technology and know-how, investment by domestic firms into the zones, forward and backward linkages and free movement of labour and entrepreneurs between the zone and the surrounding economy (Farole, 2011).

Box 3.7. **Main productivity and efficiency programmes for SMEs in the Philippines**

- The National Industry Cluster Capacity Enhancement Project: a three-year technical cooperation project funded by the Japan International Cooperation Agency (JICA) to develop and mobilise pilot industry clusters nationwide.
- Shared Service Facilities: common service facilities or production centres for certain processes to give MSMEs access to better technology and more sophisticated equipment to improve their competitiveness and help them to tap a better and wider market and to be integrated in the global supply chain.
- "Shindan" for Philippine SME Counselors: a JICA-assisted programme to enhance the capacity of SME Counselors towards providing more effective and efficient delivery of business development services to SMEs.
- SME Roving Academy: a regional road show that will bring together national government and private sector institutions whose programmes are designed to promote entrepreneurship, improve access to credit and markets, and increase productivity and efficiency of MSMEs. The caravans are undertaken to improve access of MSMEs to government and private sector services particularly on areas where provision of business development services may be limited.
- Small Enterprise Technology Upgrading: provides information and direct assistance in improving productivity in selected industries.
- Technology Business Incubator Program: common service facilities for main SME industries where the Department of Science and Technology rents/sells equipment/utilities until the new firms are able to establish their own.
- The National Wages and Productivity Council of the Department of Labor and Employment, in collaboration with social partners, drew up the ISTIV Productivity Awareness Program to enhance the competitiveness and productivity performance of MSMEs through the installation of the programme's productivity technology.
- Technical Vocational Education and Training (TVET).

Source: BOI (2014)

The *Special Economic Zones Act* of 1995 does encourage linkages, and some partnerships between ecozones and vocational training institutes have boosted skills within and around the zones. Skill levels have also risen in the ecozones, accompanied by an increase in skill-intensive design and research activities in the electronics sector labour force, but studies have criticised the lack of forward and backward linkages created through ecozones and an over-reliance on the electrical and electrical machinery sector. Nine out of the top ten PEZA exporters belong to this sector which tends to use a high proportion of imported inputs, with local suppliers mostly providing low value-added and low-technology products and services (Manasan, 2013).

Zone-based strategies are intended to create jobs and exports, but they have been criticised for failing to sustain innovation and competitiveness, technological upgrading and new firm creation. Economic activities within free trade zones, allowing for lower import and export costs, tend to have weak linkages with the rest of the economy if not firmly embedded in a wider development agenda, including appropriate connectivity to the rest of the economy and reduced barriers to investment (OECD, 2014a). Ensuring that zones develop positive linkages to the domestic economy often requires that complementary, economy-wide policies in areas like skills development, knowledge-sharing and cluster policy be co-ordinated with zone development (FIAS, 2008).

These considerations have to be part of the government's efforts to promote inclusive growth, a key element of which is the creation of linkages between local smaller enterprises and large investors, including foreign investors. The government should reconsider its zone based strategy, to incorporate ecozone successes in improving business climates, while addressing the lack of dynamic linkages created with the local economy. The Philippines is ripe for a more elaborate and comprehensive strategy of cluster development. The existence of industry clusters at the local level represents an important location factor for many MNEs. The DTI, through its Regional Development Group, launched a clusters initiative in 2013 but is encouraged to use the ecozones more in its implementation.

Moving from zones to clusters is a logical progression. In the Philippines, ecozone managers have mandates to develop zones and attract locators.[22] Ecozones have demonstrated significant enterprise agglomeration effects, gathering numerous MNEs and local investors which could be a stepping stone to building dynamic clusters if accompanied by appropriate measures that support critical elements such as industry-guided SME promotion in surrounding areas and collaborative arrangements with competent research and higher education institutions. The example of CzechInvest's cluster model (Box 3.8) provides useful insights.

Box 3.8. **CzechInvest's sectoral clustering: Moravian-Silesian Automotive Cluster**

CzechInvest cluster support

Czechinvest has established a cluster support programme to promote innovation and increase the competitiveness of the Czech economy. CzechInvest supported clusters must comprise a minimum of 15 companies, with at least 60% SME participation and at least one research or higher education institution. The programme has supported cluster formation through sector mapping, feasibility studies for sustainable clusters, and the creation of cooperation platforms between companies. It also facilitates cluster development by providing infrastructure for human resources development, innovation, R&D and technology development and transfer; and coverage of running costs including cluster management, market analysis and joint projects.

The Moravian-Silesian Automotive Cluster

The Moravian-Silesian automotive cluster, located in a long-standing industrial region in the eastern Czech Republic, aims to improve the competitiveness and export capacity of cluster members, foster innovation, and promote the region and its automotive industry. The Czech automotive cluster has achieved international recognition with a tradition of engineering supported by relevant high-quality education, an extensive supplier base and adapted infrastructure and industrial facilities. The cluster has over 60 members in the Moravian-Silesian region and its surroundings, including several local academic and R&D institutions, such as the Technical University of Ostrava. Founded in 2006, its legal base is an association. In addition to being self-financing, it has benefited from CzechInvest subsidies.

The cluster offers services and facilities for R&D, such as laboratories for noise, heat and cooling testing. It promotes member cooperation and the sharing of practices, experience and skills. For example, the cluster website provides member services with a catalogue of existing technical and design solutions, access to cluster members' contact information, and a joint-purchasing system. The cluster further supports and expands companies' trade relations, and facilitates liaison with clients through supplier-buyer events.

Source: Moravian-Silesian Automotive Cluster, CzechInvest.

Promoting linkages

Representing 99.6% of Filipino enterprises, SMEs are a critical element of the investment promotion challenge the country needs to tackle (ADB, 2014). SMEs continue to face difficulties in accessing credit and new technology and also struggle to meet product quality standards, a requirement for successfully supplying higher value-addition production activities catering to premium export markets or even the higher end segments of the domestic market. Skilled labour to support potential growth industries such as metal casting, tool and die, auto and motorcycle parts, chemical, iron and steel industries is also scarce. This problem is compounded by a lack of domestic raw materials which leads to imported inputs, thus keeping domestic value-addition low (Aldaba, 2014).

A weak supply base can be detrimental to a country's investment attraction strategy (Farole, 2011). Anchoring investors through deep linkages with the local economy is also an effective investment retention strategy. Investor targeting and after-care services can attract and retain investors, but it is the broader and more sophisticated, and efforts to strengthen the investment ecosystem that will determine a country or region's competitiveness. This includes providing investors with competitive local suppliers, facilitating linkages with local firms, developing the necessary hard and soft infrastructure, including institutional support, and keeping policy and macro-economic fundamentals in order.

Business linkages between MNEs and domestic companies, especially smaller suppliers, contribute significantly to local development and inclusive growth. Linkages can be effective avenues for technology and knowledge transfer, depending on the appropriate policy setting and absorptive capacity of domestic suppliers. An enabling environment that is conducive to SME growth and competitiveness is critical, including SME promotion and support measures ranging from streamlining business regulations to targeted vocational training and other business development services.

The potential of MSMEs in the Philippines to benefit from FDI depends not only on the amount of investment but also on its quality. Targeting the type of enterprises that are more prone to develop backward linkages must be central to the Philippines' investment strategy, if it is expected to contribute significantly to inclusive growth. For instance, market-seeking investors are often associated with closer linkages with domestic suppliers, given that they need local market intelligence as well as inputs customised for the local market. With a large proportion of FDI in the Philippines being export-oriented and confined to ecozones, the impact of FDI beyond job creation is structurally limited. Investor feedback in the Philippines demonstrates a clear interest in catering to the fast-growing local market,[23] but such opportunities face structural barriers, including restrictions on FDI outside ecozones and the challenges of doing business.

In Indonesia for example, market-seeking FDI has gained importance vis-à-vis natural resource-seeking investments. FDI has played an important role in Indonesia's competitiveness. MNEs in Indonesia have been found to have generally higher productivity than domestic firms, and these productivity advances have spilled over to domestic firms. The productivity of domestic manufacturing firms is positively correlated with contacts with foreign suppliers, but not with contacts with foreign customers. Transferring knowledge to its customers is often in the interest of foreign firms, but backward spillovers, arising from the presence of MNEs in downstream sectors, are shown to be limited (Molnar and Lesher, 2008).

The other side of the linkages equation is the absorptive and productive capacity of domestic SMEs. In this regard, the government is undertaking a vast range of SME promotion activities. While government efforts to promote SMEs date back to the 1970s, it was the 1991 Magna Carta for MSMEs (RA 6977, as amended by RA 8289 and RA 9501) that marked the first major SME legislation. Its main aim was to consolidate all SME promotion initiatives into a single institutional framework.[24]

An important aspect of any SME promotion strategy is a clear definition and reliable statistics. SME statistics are generally very detailed and allow for thorough analysis and policy development. In the Philippines, SMEs are defined by number of employees and by assets as follows:

Table 3.4. **SME categories in the Philippines**

Category	Employees	Assets
Micro	1-9	P3 million or less
Small	10-99	P3-15 million
Medium	100-199	P15-100 million
Large	200 or more	P100 or more

Source: Aldaba (2013).

Access to finance, and the capacity to benefit from financial inclusion initiatives, is one of the main challenges SMEs face worldwide, including in the Philippines. In this regard, the Bangko Sentral ng Pilipinas' (BSP) recognises the vital role of SMEs for economic growth and development, as reflected in the *General Banking Law* (RA 8791), where the needs and peculiarities of microfinance borrowers are taken into consideration in provisions pertaining to loans. Based on both the *General Banking Law* and the Magna Carta for MSMEs, policies meant to promote MSME lending, as well as access to other crucial financial services have been developed by BSP. These include promoting financial inclusion through the provision of a wide range of products for MSME clients, expanding virtual reach through electronic money, lowering barriers to customer acquisition and expanding the physical reach of banks through the micro-banking offices as well as consumer protection and financial education. The BSP also actively partners with different organisations including international standard setters, to advance financial inclusion policies and programmes for developing countries such as the G20 Global Partnership for Financial Inclusion Subgroup on Regulation and Standard Setting and Basel Consultative Group Workstream on Financial Inclusion. Box 3.9 highlights some of these measures.

Box 3.9. **MSMEs support measures by BSP**

- Mandatory Allocation of Credit Resources to MSMEs: From 17 June 2008 to 16 June 2018, banks are required to allocate a minimum of 8% of its total loan portfolio for micro and small enterprises and at least 2% for medium enterprises based on the balance sheet as of the end of the previous quarter.
- The National Retail Payment System facilitates easier transfer between accounts and unifies automated teller machines, mobile money and electronic point-of-sale. The National Strategy for Financial Inclusion (NSFI) from April 2015 is a joint initiative of BSP and 13 other agencies providing a framework enabling the public and private sectors to take a coordinated, organised, and efficient approach in bringing much-needed financial services to all, especially the low income and marginalised sectors.
- Investments in Venture Capital Corporation: Banks are authorised to invest in the equity of venture capital corporations subject to certain requirements and conditions. These corporations refer to entities organised jointly by private banks, the National Development Corporation and the Technology Livelihood and Resource Center or any other authorised government agency. The main purpose of the venture capital corporation is to develop, promote and assist SMEs through debt or equity financing or any other means.
- Documentary requirements for MSME loan clients: Exemption of loans granted to MSMEs until end-2014 from submitting the borrower's latest income tax return and if the borrower is engaged in business, a copy of his latest financial statements as submitted for taxation purposes to the BIR.
- MSME loan regulations: (i) The risk weight assigned to qualified MSME loans lowered from 100% to 75%; (ii) Increased single borrower's limit by 10% for SME receivables; (iii) Exemption of borrowings by accredited financial institutions under the Wholesale Lending Program for SMEs of the Small Business Guarantee and Finance Corporation from the reserve requirement.

Box 3.9. **MSMEs support measures by BSP** (cont.)

- Branching liberalisation: Exemption of branches of microfinance-oriented banks, microfinance-oriented branches of banks which are not microfinance-oriented from the moratorium on establishing branches in restricted areas within Metro Manila subject to certain requirement and conditions.
- Rediscounting window available to thrift banks to provide liquidity assistance to support and promote microfinance programmes and to rural and cooperative banks to provide liquidity assistance to support and promote microfinance programmes.
- An increase in 2013 of the average daily balance for micro deposits up to PHP 40 000 to promote higher savings rate among microfinance clients.
- Simplification procedures for approving housing microfinance loans and micro-agri loans in 2013.
- In 2014, amendment of the general features of the micro-insurance products under Appendix 45 of the Manual of Regulations for Banks (MORB) to align with the provisions of the Insurance Code and of the maximum amount of contribution, premiums, fees or charges, computed on a daily basis, from 5.0% to 7.5% of the current daily maximum wage rate for non-agricultural workers in Metro Manila.
- Widening the scope of allowable activities and services that Micro Banking Offices can provide to address limited rural access to financial services (26 January 2015).

Source: BOI (2014), BSP (2015)

Through its Economic and Financial Learning Program, the BSP has helped to raise financial awareness of microfinance investors through information campaigns on economic and financial issues and programs for overseas Filipinos and their beneficiaries. The Credit Surety Fund created from contributions by well capitalised and well-managed cooperatives with a counterpart contribution from the provincial government and other donors. The Fund provides surety cover, in place of acceptable collateral, to guarantee loans of MSMEs from banks, and aims to increase the credit worthiness of MSMEs which are experiencing difficulty in obtaining loans from banks for the expansion of their business due to lack of acceptable collaterals, lack of credit knowledge and lack of credit track records. The Fund also assists entrepreneurs through a liberalised form of credit to free them from excessive financing costs charged by usurious lenders. As of

December 2014, there were 37 Funds established across the country, benefiting 555 cooperatives, non-government organisations and associations, and 14 455 borrowers.

The Land Bank of the Philippines and Development Bank of the Philippines are also actively involved in developing MSME financing support programmes, while the Department of Science and Technology provides financing facilities innovative endeavours. Available SME finance programmes include:

- Access of Small Entrepreneurs to Sound Lending Opportunities Program,
- Special Credit Window under Barangay Micro Business Enterprises Act of 2002
- The *Agri-Agra Reform Credit Act* of 2010 amended Presidential Decree No. 717 or the *Agri-Agra Law* to facilitate increased credit to farmers and spur productivity

The Bureau of Small and Medium Enterprise Development attached to the DTI is one of the main SME promotion agencies. It initiates and implements programmes and projects addressing specific SME needs in technology development and transfer, financing, marketing and training, and market promotion through trade fairs. The Securities and Exchange Commission, the Bureau of Internal Revenue, the League of Cities and Municipalities, and the Department of the Interior and Local Government all work to simplify business processes for SMEs, in co-operation with the private sector and donor agencies.

Another high-profile initiative is the National Economic Research and Business Assistance Center, established as a one-stop business centre to provide assistance to start-up enterprises, particularly to support business registration and licensing and knowledge management. Following the one-stop-shop approach, it houses representatives from 13 agencies under a single roof.[25] A challenge faced by the Center is the capacity to deliver the most appropriate services at the regional level, particularly as some of the services may already be offered by LGUs (USAID, 2013).[26] Efforts to provide tax incentives to SMEs are also facing similar challenges. For example, the much publicised *Barangay Micro Business Enterprises Act* of 2002, which offered tax exemptions to SMEs, was resisted by LGUs on grounds of loss of public revenues.

The various SME Centers or desks at the DTI provincial offices as well as in some LGUs and local chambers also offer specialised business development services to MSMEs for productivity improvements, technology upgrading, market information, product and market development, financing and entrepreneurial development.

Many other SME promotion initiatives are at the disposal of local enterprises to promote market access. A cross-cutting challenge is that SMEs have varied needs when it comes to assistance in doing business and capacity building which no single provider can meet, often resulting in a vicious cycle of proliferating measures and activities, frequently overlapping and duplicating each other. This challenge is not unique to the Philippines, but the DTI and other leading agencies are encouraged to further promote clear delineation and complementarity between the various SME promotion initiatives.

In this regard, the "*Go Negosyo Act*" enacted in July 2014 [RA 10644] foresees establishing Negosyo Centers in all cities, provinces and municipalities to support MSMEs in navigating through the myriad MSME support programmes available.[27] These centres will be highly effective if they manage to improve the co-ordination among the different initiatives, including with the functions of LGUs. The centres should take into account the vast international experience of similar business development service providers to be able to provide the most relevant MSME assistance.

The Industry Roadmaps discussed earlier provide effective means to channel private sector feedback into policy making. This presents an opportunity to strengthen and sharpen the business development services the government provides to SMEs, particularly if linkages are to be promoted. The private sector plays an important role in developing skills in many economies, as businesses know best what skills they need. Beyond traditional SME promotion tools and measures, the government has launched specific business linkages projects, as follows:

- Establishing and promoting industrial sub-contracting exchange schemes to facilitate linkages between manufacturers or exporters and industrial subcontractors;
- Pilot-testing the Link-based Economic Growth Model in a specified sector, monitored and evaluated for possible replication in other sectors;
- Strengthening and activation of SME associations and groups of SMEs and industry and trade associations;
- The Backward Linkage Programme within the electronics and electrical industry to develop SME suppliers for identified MNEs within the industry. The programme has identified several MNEs needing a local supplier base and put them in contact with suppliers;

- The Centre-Satellite programme is patterned on Chinese Taipei's centre-satellite system to establish an effective industrial network integrating assembly and parts industries by strengthening the ties between large scale industries and their "satellites of current suppliers". Satellite factories can improve their operations through the guidance and assistance of the centre factory.

The BOI, as the country's main IPA, is well placed to connect investors with potential suppliers. Although IPAs generally share this position of being the node between foreign and domestic enterprises, evidence of linkages promotion by IPAs is scarce. This is often due to a lack of budget and mandate for promoting linkages (UNCTAD, 2006). For example, the BOI organised reverse trade fairs, where local auto parts manufacturers could display their products to downstream customers, including foreign MNEs, but, despite the good reputation of the initiative, it was dropped due to a lack of mandate.[28]

The BOI regularly invites local enterprises to meet with potential investors, arranges meetings between potential investors and industry associations, and invites officers of various chambers of commerce during investment briefings for potential investors. It also organises match-making meetings for investors and SMEs. Since the new IPP stresses a value chain approach, the IPA network has only recently started addressing the importance of connecting investment and SME promotion, hence linkages.[29] This platform, along with the Industry Roadmaps, is likely to produce practical initiatives to facilitate business linkages.

Notes

1. NEDA, 2014, www.neda.gov.ph/?p=3200
2. Aldaba 2014. www.eastasiaforum.org/2014/03/01/revving-the-engine-of-philippine-manufacturing/.
3. See the high level conference on "Inclusive growth through inclusive business" in September 2014. www.pbsp.org.ph/news/forum-on-inclusive-growth-through-inclusive-business-marks-bois-47th-anniversary/.
4. BOI, Investment Policy Review Task Force meeting, Manila, 14 November 2014.
5. Presentation by Linda B. Pamintuan, Executive Director, SCAD, 5 February 2014 to the Congress of the Philippines, House of Representatives

6. 20-foot equivalent units.

7. These representatives come from the Bureau of Immigration, Bangko Sentral ng Pilipinas, the Department of Labor and Employment and the Securities and Exchange Commission that are members of the Investments Promotion Unit Network, as well as the Philippine Industrial Estate Association.

8. The Department of Environment and Natural Resources–Environmental Management Bureau, the Food and Drug Administration, the SEC, the Department of Tourism, and the Department of Health–Health Facilities and Services Regulatory Bureau.

9. The Housing and Land Use Regulatory Board, the Department of Agriculture and the Department of Energy.

10. Such as the Department of Trade and Industry, the SEC, Cooperative Development Authority, Bureau of Internal Revenue, Social Security System, Home Development Mutual Fund, Philippine Health Insurance Corporation, local government units and other permit/licence-issuing agencies.

11. Based on the Stakeholders' Engagement Survey conducted in 2015 by Novo Trends PH, an independent social research company, the BOI received an "excellent" net satisfaction rating (or a ratio of eight out of every ten stakeholders) from BOI registered companies, prospective and would-be investors who previously made investment inquiries with the agency, industry groups, associations, and chambers. The high level of satisfaction was attributed to the agency's staff competence, wherein, three out of four respondents said that BOI staff are knowledgeable, helpful, and courteous.

12. The Department of Finance estimates forgone revenue in 2011 to be PHP 144 billion or 1.5% of GDP, and over 10% of the government's revenue (BIR, 2014). This includes PHP 83 billion of duty free imports which, it could be argued, are an essential precondition for any export-oriented investor. PEZA reports that investors availed themselves of income tax holidays (ITH) worth PHP 23 billion in 2011, while paying direct company taxes of PHP 50 billion. BOI cites 2011 figures for ITH of PHP 31 billion, while investors invested PHP 814 billion, paid taxes of PHP 14 billion and created 151 879 jobs.

13. www.oecd.org/investment/investment-policy/2506900.pdf.

14. www.peza.gov.ph/index.php/about-peza/special-economic-zone-act.

15. PEZA, as per OECD Policy Framework for Investment Survey, 2014.

16. OECD onsite interviews with PEZA, Subic and Clark, February 2014.

17. OECD onsite interview with SBMA, February 2014.
18. www.fdiintelligence.com/Locations/fDi-Global-Free-Zones-of-the-Year-2015-Winners.
19. www.blr.dole.gov.ph/frequently-asked-questions/29-dole-pnp-peza.www.blr.dole.gov.ph/frequently-asked-questions/29-dole-pnp-peza.
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22. BCDA, Investment Policy Review Task Force meeting, Manila, November 2014.
23. www.malaya.com.ph/business-news/business/domestic-ecozones-mulled-peza-investments-surge.
24. http://dirp3.pids.gov.ph/ris/dps/pidsdps1205.pdf.
25. These include the DTI, Bureau of Internal Revenue, Social Security system, Home Development Mutual Fund, Philippine Health Insurance Corporation, Cooperative Development Authority, Department of Labor and Employment, Department of Environment and Natural Resources, Mines and Geosciences Bureau, Securities and Exchange Commission, a One-Stop Export Documentation Center composed of, among others, the Bureau of Customs and the Bureau of Plant Industry-Plant Quarantine Services, the Philippine Contractors Accreditation Board, and the Intellectual Property Desks.
26. USAID (2013).
27. www.gov.ph/2014/07/15/republic-act-no-10644/
28. BOI, Investment Policy Review Task Force meeting, Manila, 14 November 2014.
29. BCDA, Investment Policy Review Task Force meeting, Manila, November 2014.

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Chapter 4

Competition policy in the Philippines[1]

This chapter reviews the competitive landscape in many sectors in the Philippines and discusses the importance of the new Competition Act for providing greater contestability of markets. It suggests some areas to consider in the implementing regulations which will accompany the new Act.

Summary

The adoption of the Philippine *Competition Act* in July 2015 marks the end of over 20 years of legislative discussion over the law and signals the country's readiness to tackle the anti-competitive practices and regulatory barriers that dominate the business landscape. The Philippines now meets its ASEAN commitment to have a comprehensive competition law in place by the end of 2015. The competition law is expected to stand the country in better stead to attract inward investment, promote sustainable and inclusive growth, and facilitate access to global markets in future trade negotiations. These are high expectations for a new competition law in an economy characterised by private conglomerates with strong ties to the political elite and a weak competition culture. The effectiveness of the new law will come down to its implementation and the ability of the new Competition Commission to take-on the anti-competitive practices of incumbents that are considered the norm in the Philippines. The new competition regime will require on-going support from the administration and must be free from actual or perceived interference by politicians or vested interests.

The major economic challenge for the Philippines is to sustain its recent positive economic growth trajectory and reduce poverty and inequality. Trade and structural reforms since the 1980s introduced competition in some sectors, but not all sectors have been liberalised to the same extent. A number of key industries still have high levels of protection from foreign competition in the form of import restrictions, regulatory barriers and behavioural constraints.

An inadequate competition policy regime explains in part why the Philippine's oligopolistic market structure persists. Although a number of sector or industry-specific competition laws exist, as well as regulatory arrangements to regulate network industries, they do not consistently deal with the wide range of anti-competitive practices that have emerged or could emerge in different sectors.

Sectors that had previously been dominated by monopolies, such as telecommunications and air transport, have demonstrably benefited from past reform efforts that opened them up to competition. The push for competition law and introducing more competition into the economy has been to sustain economic growth and build on these previous reforms. It is now seen as a key part of a package of measures necessary to boost growth and FDI, and to improve the business climate.

An economy-wide competition law and policy is necessary to combat on-going and potential anti-competitive practices that are not sanctioned under the existing legal framework. In the short term, the government's

resolve to enhance competition by appointing the Office for Competition (OFC) before the enactment of the 2015 *Competition Act* was a step in the right direction. The OFC has done a remarkable job of putting competition on the map and pushing for a change in accepted business practices and regulatory restrictions, despite not having any effective sanctions under the existing legislation. But in the long-term the Philippines needed a comprehensive competition law and a strong and independent competition authority equipped with the necessary enforcement powers and tools to effectively identify and tackle anti-competitive practices.

Like some other countries in Asia, the Philippines suffered from a history of political instability and a political economy controlled by an oligarchic elite. Political and socio-economic power remains in the hands of a few well-connected families and a high concentration of ownership persists in the Philippines. This poses a challenge for effective competition and therefore for implementing and enforcing a comprehensive competition law along with other meaningful domestic economic reforms. This goes some way to explain the country's relative underperformance in economic development and poverty reduction compared to its neighbours. These political economy issues will present a challenge to the effective enforcement of the new competition law and to how competition will be introduced into the many monopolised and cartelised markets that are features of the Philippine economy.

The ASEAN commitment to economic integration and the adoption of an economy-wide competition law by 2015 has provided the necessary push to enact competition legislation. Support for the law has also come from domestic forces, despite the political constituencies and factions that contributed to holding it up over the last two decades. The administration has demonstrated that it is not afraid to tackle vested interests in areas that had previously been too sensitive to reform. The challenge will be to maintain this momentum and embed a deep-seated change in business practices.

The establishment of the OFC had the political backing of the President but was sometimes hampered by the lack of an enabling framework and sanctions. It therefore lacked the necessary enforcement tools and powers to promote effective deterrence and encourage compliance by business and government agencies, although it effectively helped to tackle collusion in recent high profile cases in the garlic and onion sectors. It has also managed to raise the profile of competition policy and the OFC's activities.

The new *Competition Act* should be assessed in the context of international best practice as well as the realities of the Philippine market economy. The text reflects the compromises made over the 20 years of negotiations in Congress following pressures from different vested interests seeking to protect their positions. It also reflects additions and modifications inserted to address concerns about guarding against these vested interests and the politicisation of competition policy and enforcement. Many of these do not appear in the laws or guidelines of competition authorities in other jurisdictions, either in Asia or in more established competition jurisdictions. For example, the law includes a controversial exemption for predatory pricing where prices were established "in good faith", which may exonerate dominant companies resorting to predatory pricing. It also provides for a number of unusually broad and vague exemption powers for the new Competition Commission, including the power to exempt an entity from the *Competition Act* if the Commission determines that the exemption does not impede competition or enforcement of the Act, or that competition is not necessary to attain the competition policy behind the law. There is a high degree of discretion in the application of such an exemption, both to approve an exemption but also to withdraw it once granted. Moreover, it is surprising in an economy characterised by large conglomerates that the exemption applies to entities rather than a specific agreement or practice that meets particular statutory standards.

A significant challenge will be for the implementing rules and regulations to clarify the provisions, as well as the powers and functions of the new Commission as set out in the new law. They should be designed such that they facilitate implementation and clarify the remaining gaps and potential ambiguities in the new law.

Another concern is the interaction of the new competition law with the existing price control regime for basic commodities which is out of step with economic reforms to introduce more competition in the economy. No consideration has been given to removing or scaling back the regime as part of the package of economic reforms, although the OFC published a study in June 2015 that called for the review of the Suggested Retail Price mechanism because it distorts competition and recommended that price control be limited to emergencies or natural calamities.

The long-term outlook for the Philippines and the government's objectives of inclusive growth and poverty reduction depend fundamentally on the government's ability to implement policies that improve the business environment. The government needs to follow through on a programme of economic reforms underpinned by the new competition regime. This will provide the necessary policy support to continue liberalising key sectors of the Philippine economy and open up the economy to competition. More competition will raise productivity and create more jobs, while more contestable markets will spur investment from both domestic and foreign sources. The next step will be to operationalise the new competition law and the new Competition Commission alongside the adoption of a whole-of-government policy on competition to support the review and reform of regulatory barriers to competition.

The impact of liberalisation reforms on product market competition

The Philippines began to undertake political and economic reforms in the late 1980s and early 1990s. It shifted from import substitution to export-oriented policies and introduced more liberal trade and investment policies. The Philippines made significant progress in opening up the economy to competition by removing tariff and non-tariff barriers in the manufacturing and agricultural sectors. Average nominal tariff rates were reduced from a range of 70 to 100% to within a 3 to 30% range. Effective protection rates declined from 53% in 1983 to around 3% by 1996. By 1998 most quantitative restrictions were removed, except for rice. These trade reforms were accompanied by privatisation and deregulation policies. Reforms were initiated in the financial sector as well as utilities, including telecommunications, power, water, air transport, and shipping. Investment liberalisation centred on allowing foreign investment in sectors that were not specified in the Foreign Investment Negative List. These reforms aimed at removing barriers to competition and promoting high and sustained economic growth and rapid poverty alleviation.

In some sectors, trade reforms beginning in the mid-1980s introduced greater competition and have limited the potential for abuse of market power. For example, the increase in competitive pressures in sectors such as agricultural machinery as well as metal and paper-based industries has had the dual effect of decreasing firm concentration and lowering domestic prices toward international levels. However, a number of industries remain protected from foreign competition. For example, in-quota and out-quota tariffs exist for selected agricultural products, such as sugar and rice. Import restrictions and other protective measures have also led to high market concentrations in many manufacturing industries, including cement, iron steel, glass and plastics.

Notwithstanding these trade reforms, a continued lack of competition in the manufacturing and agricultural sectors is a major reason for the Philippine's traditionally low growth rate. Regulatory barriers and price controls are prevalent in the agricultural sector. Even where import restrictions have been removed in parts of the manufacturing sector, many industries show signs of collusion, either due to structural barriers or behavioural constraints.

Box 4.1. **Impact of tariff and non-tariff barriers on competition: Sugar, glass and cement industries**

Sugar: The government established Sugar Regulatory Administration controls and regulates the sugar market. It also enforces a production sharing system between domestic planters and millers, which is a disincentive for producers to increase productivity and reduce costs. The industry is protected from imports through in-quota tariffs and is dominated by integrated sugar magnates who control milling, refining and marketing. The oligopolistic structure of the market has led the high cost of domestic sugar even when there has been a worldwide glut. This has also resulted in the reduced competitiveness of industries such as food processing that use large quantities of sugar for their products.

Glass: The glass industry has been heavily protected from imports through quotas and tariffs, and three dominant firms contribute 84% of the total industry value-added. The flat glass sub-sector, a capital and skill-intensive industry, has only one domestic producer.

Cement: The industry has historically been heavily cartelised, with firms colluding to set production quotas and prices and allocating geographic markets. With the introduction of more import-driven competition in the domestic market from 2000 to 2001, the industry succeeded in obtaining protection through safeguard measures, which eliminated import competition. However, even when these measures were withdrawn in 2004, the highly fragmented nature of the domestic cement market due to high inter-island transport costs made the industry susceptible to collusion.

Source: Aldaba (2008).

Reforms in the non-traded service sector promoted a number of liberalisations in key industries in the late 1980s and 1990s, opening sectors such as telecommunications and air transport to greater competition which helped to sustain growth over the next decade.

The telecommunications sector was liberalised in the 1990s, opening up an industry that had been dominated by a private monopoly for more than 50 years. Air transport was deregulated in the mid-1990s and restrictions on domestic routes and frequencies as well as government controls on rates and charges were eliminated. Generation in the power sector was opened up in 1987 and the *Electric Power Industry Reform Act* (EPIRA) was introduced in 2001, which restructured the industry by allowing competition in generation and supply and by regulating transmission and distribution. The water sector was privatised in 1990 through competitive bidding. The banking sector was liberalised in the 1980s and entry of foreign banks was allowed by the mid-1990s. A new law further liberalising foreign bank entry was enacted in 2014, allowing 100% foreign ownership of banks. Deregulation of domestic shipping rates began in 1989 and by 2004 domestic shipping operators could establish their own rates, which improved market conditions, although rates remain relatively high. Further reforms in 2014 streamlined regulations to facilitate market entry.

Table 4.1. **Barriers to entry and competition in selected industries**

Sector	Source of barrier
Agriculture: Rice	Import licences or tariff quotas
Agriculture: Corn	Cartel behaviour by dominant producers
Agribusiness	Restrictions on foreign land ownership, restrictive land use policies
Downstream oil	Cartel behaviour by oligopolistic producers, large capital requirement
Pharmaceutical drugs	Licensing/registration restrictions, cartel behaviour by dominant firms
Cement	Cartel behaviour by oligopolistic producers, large capital requirement
Electricity distribution	Monopoly, limited regulatory capacity
Water	Local monopoly, multiple fragmented/overlapping administrations
Telecommunications	Congressional franchise, limited regulatory capacity
Ports	Monopoly, limited regulatory capacity
Shipping	Cabotage Law, cartel behaviour by local oligopolies
Air transport	Cabotage Law, congressional franchise, limited regulatory capacity

Sources: World Bank (2015) and Aldaba (2008).

The reforms deregulated and liberalised infrastructure utilities and opened these markets to competition, but they have not been sufficient to ensure efficient and competitive markets. Market structures in many of these sectors remain oligopolistic and entry barriers are prevalent, with Constitutional restrictions limiting foreign equity participation to 40%.

In the telecommunications sector, interconnection between the incumbent and new entrants remains a regulatory challenge, and the sector has reconsolidated back to a situation where competition is widely seen to be lacking. In the retail power sector, a lack of competition has led to high prices and supply constraints. In air transport, the domestic market is characterised by duopolists on major routes and monopolies on minor routes. And unlike the domestic sector, international air travel remains heavily regulated and the government has yet to implement a full open skies policy.

In ports, competition is limited due to the conflict of interests arising from Philippine Ports Authority's multiple roles as regulator, operator, and developer of the ports sector. In shipping, restrictions on cabotage that limited competition from foreign shipping companies and meant only a few firms controlled most of the primary routes, have only just been lifted following the amendment to the *Cabotage Law* adopted in July 2015. The removal of the cabotage restrictions are expected to contribute to a reduction in inter-island shipping costs. These costs are high due to existing constraints in port infrastructure and the cabotage restrictions that prevented more efficient foreign ships from servicing domestic routes.

Notwithstanding the steady rise in the *Global Competitiveness Index* ranking between 2012 and 2015, the Philippines, in 47th place, still lags behind its neighbours. Singapore ranked 2nd, Malaysia 18th, Thailand 32nd and Indonesia 37th in the World Economic Forum's rankings. While the Philippines is slowly closing the gap on its ASEAN peers, it is ranked 5th in ASEAN. And while it has made great strides, ensuring healthy competition remains a significant challenge. According to the 2015 rankings, the Philippines ranks 56th on the intensity of local competition and among the worst in ASEAN for the extent of market dominance of companies (87th) and the effectiveness of anti-monopoly policy (74th).

Consequently, in spite of these market-opening reforms and liberalisation policies, competition and productivity growth in the Philippines remain weak. Informal workers and the poor, in particular, appear to have benefited least from the reforms as evidenced by the slow pace of poverty reduction in the decades following liberalisation. It is clear that liberalisation efforts do not automatically lead to a competitive domestic economy. Consequently, the absence of clear rules and appropriate regulatory frameworks as well as efficient regulators and infrastructure constraints, has limited effective competition in many sectors of the Philippine economy. Fundamentally, these markets reforms, though well-intentioned, lacked the necessary policy support measures, notably in the form of a comprehensive competition law, to support an enabling business environment to level the playing field between firms of all sizes and origins.

The competition provisions found in various legislative acts (prior to the 2015 *Competition Act*), including the Constitution, and the institutional arrangements to regulate natural monopolies, have proved inadequate in dealing with the wide range of anti-competitive practices and barriers prevalent in the country's oligopolistic markets and the strong ties between the economic and political elite. The absence of a comprehensive competition law has also held back infrastructure investment and FDI in the Philippines, while enabling rent seeking by incumbents. Poor infrastructure development, notably in roads, power stations, ports, airport capacity and schools, is a constraint on growth and investment. The lack of infrastructure and security of energy supplies is cited by business leaders as a major reason for the difference in the lower amount of FDI the Philippines receives compared to its ASEAN neighbours. Concerns have also been raised about perceived corruption, bureaucracy, regulatory unpredictability and the lack of a level playing field given the many monopolised and cartelised markets that are features of the domestic economy.

There is widespread recognition that as the government follows through with its programme of deepening structural reforms, this must include a clear and effective competition policy for the Philippines. Reforms to strengthen competition in the economy have culminated in the introduction of a comprehensive competition law and the establishment of a central institution to enforce the law. The impetus for a competition law has been to sustain economic growth and build on previous reforms. Improved competition requires improved investment and business activity to absorb the growing labour force. It is seen as part of a package of measures necessary to boost competition and FDI.

The Philippine Development Plan 2011-16 (PDP) includes a unified competition law as a cross-cutting policy reform as part of its good governance measures. The law is cast as a measure to enhance "economic justice", necessary for inclusive growth. The PDP highlights the government's role in promoting competition and making it easy for firms, regardless of size, to do business in the country. It also notes the government's role in promoting a consistent and predictable policy environment to "level the playing field by strengthening the legal and institutional framework to prevent unfair and anti-competitive practices". The Plan envisages that strengthening the legal framework on promoting competition "will not only improve the country's competitiveness but also rationalise commodity prices". The competition law is also listed first of the priority policies and legislation aimed at fostering an enabling environment for infrastructure development.[2]

Development of competition law in the Philippines

The history of competition law in the Philippines can be traced back to the Old Penal Code enforced by the Spanish regime. Subsequently, under American rule the *Act to Prohibit Monopolies and Combinations in Restraint of Trade* (Act No. 3247), which was based on the 1890 *US Sherman Act*, was enacted in 1925. This was largely replaced by the restraint of trade provisions in the Revised Penal Code 1932, which until the 2015 *Competition Act*, constituted the main law addressing anti-competitive behaviour in the Philippines.

The Constitution of 1987 sets out basic competition policy with reference to the control of monopolies in Article XII (19). The New Civil Code 1949 provides for a right of action for any person suffering damages due to unfair competition. The *Price Act* prohibits cartelisation designed to manipulate prices of basic necessities and prime commodities. The Republic Act 4152 of 1964 (Amending the Law Prescribing the Duties and Qualifications of Legal Staff in the Office of the Secretary of Justice) tasks the Justice Secretary with legal and enforcement duties related to competition. Other legal provisions scattered in several statutes seek to prohibit certain anti-competitive practices, which are enforced by various government agencies and regulators, but until now there has been no single economy-wide competition law.

Pending the enactment of a fully-fledged competition law, President Aquino, designated the Department of Justice as the country's competition authority in June 2011 (EO 45) and established the Office for Competition (OFC). The OFC's mandate is to supervise markets in order to enforce existing competition laws and investigate and prosecute violations, as well as to prepare studies on competition to inform industry and consumers. The designation of the Department of Justice as the competition authority is in line with its general mandate to enforce laws and prosecute offenders and its function as the government's principal legal counsel and prosecution arm. The sector regulators continue to enforce the competition provisions in their respective sector regulations.

There have been successive attempts to introduce a competition law in the Philippines since the early 1990s. Numerous bills have been presented to both houses of Congress without ever being approved. Previous versions of the bills before earlier Congresses succumbed to lobbying by selected business interests keen to maintain the status quo and did not receive sufficient support. Political backing came when President Aquino assumed office in 2010. The President identified the passage of a comprehensive competition law as a policy priority in his first State of the Nation Address: "According to our Constitution, it is the government's duty to ensure that the market is fair for all. No monopolies, no cartels that kill competition. We need an Anti-Trust Law that will give life to these principles, to afford small- and medium-scale enterprises the opportunity to participate in the growth of our economy".

Another important driver for the competition law was ASEAN commitments. The ASEAN Economic Community is to be established by 2015, and the government is busy putting in place measures to prepare for regional economic integration. This includes commitments set out in the 2007 ASEAN Economic Community Blueprint – a roadmap for regional integration – that gave each ASEAN member a target date of the end of 2015 by which to establish a national competition policy. To date, eight of the ten ASEAN Member States (Indonesia, Lao PDR, Malaysia, Myanmar, Singapore, Thailand, Viet Nam and now the Philippines) have adopted a comprehensive competition law and policy.

Box 4.2. **Overview of competition-related laws and provisions prior to 2015**

- 1987 Constitution
- Act to Prohibit Monopolies and Combinations in Restraint of Trade 1925
- Revised Penal Code, as amended 1932
- Public Service Act, as amended 1936
- New Civil Code 1949
- Civil Aeronautics Act, as amended 1952
- Amending the Law Prescribing Duties and Qualifications of legal Staff in the Office of the Secretary of Justice 1964
- Insurance Code 1974
- Corporation Code 1980
- National Food Authority Act 1981
- Revised Securities Act 1982
- Consumer Act 1992
- Price Act, as amended1992
- New Central Bank Act 1993
- Public Telecommunications Policy Act 1995
- Intellectual Property Code 1997
- Downstream Oil Industry Deregulation Act 1998
- Anti-Dumping Act 1999
- Retail Trade Liberalisation Act 2000
- Deposit Insurance Law 2000
- Securities Regulation Code 2000
- Electric Power Industry Reform Act 2001
- Government Procurement Reform Act 2003
- Domestic Shipping Development Act 2004
- Universally Accessible Cheaper and Quality Medicines Act 2008
- Philippine Cooperative Code 2009
- Real Estate Service Act 2009
- Rent Control Act 2009
- Food and Drug Administration Act 2009
- Pre-Need Code 2009

Note: Some of these are at the periphery of competition law regimes, and others deal with civil remedies for parties affected by unlawful conduct.

Source: OFC Brochure Advancing Economic Justice for All.

The competition law also gained support from the academic community and the media, and more recently the business community. A number of business organisations in the Philippines publicly backed the introduction of the law, particularly since it gained political traction. The Joint Foreign Chambers of Commerce has been an active proponent of a competition law and other pro-competitive reforms, given their impact on market access for its foreign members.[3] The Philippines Chamber of Commerce, the largest business association, voiced its support for the law in a signed manifesto.[4] The export sector, particularly the Philippine Exporters Confederation, issued a statement supporting the passage of the law as a means of attracting investments and ensuring that businesses are able to operate on a level playing field, especially with the ASEAN Economic Community just around the corner.[5] The Makati Business Club, which consists of the country's biggest businesses, expressed cautious support for the law, noting concerns over proposals in some versions of the bills for retroactive application of the law and high penalties.[6] The academic community has provided considerable research on product market competition in the Philippines, highlighting the need for a competition law and further economic reforms to address market inefficiencies and eliminate anti-competitive practices. Vocal media commentators have kept the competition law debate active in the press with discussions on the timeliness of introducing competition law to counter entrenched interests and address inequalities, especially given that their dynamic ASEAN counterparts already have strong legal frameworks in place to promote competition.

The various bills over the years have differed on the scope of prohibited acts, the inclusion of a merger review regime and the institutional arrangements for the competition authority. Many of these different positions reflected the competing interests of the legislators and their stakeholders, which include both the public and private sectors. Deliberations in both Houses during the 15th and 16th Congress benefited from public hearings that sought input from national and foreign experts. This has facilitated comparison of draft provisions with international best practice and established competition principles, which it was hoped would bolster the final text and make it harder to support amendments to water down the provisions.

The 15th and 16th Congress made significant progress with enacting a competition statute, culminating in the adoption of the Competition Act on 21 July 2015. During the 16th Congress each house successfully consolidated the different competition bills before it, resulting in the approval by the Senate of draft bill SB 2282 on 14 December 2014, and the adoption of the House version of the draft bill HB 5286 on 19 May 2015. The two bills went into a bicameral committee process at the start of June

2015 with representatives of both Houses to harmonise them into one bill, where additional amendments were made. A consolidated version was agreed in the bicameral committee and was subsequently approved by both houses on 10 June 2015. The Act was signed by the President on 21 July 2015, before his last State of the Nation address later that month. The law came into force on 17 September 2015.

In the interim, the Department of Justice issued *Guidelines on the Enforcement of Competition Law*, which took effect on 15 May 2015. The Department Circular proscribes specific competition prohibitions and related acts that may constitute a breach in pursuance of the existing legal provisions set out in the statutes listed above. The Circular states that entities engaging in such conduct may be the subject of an OFC investigation. Departmental Circulars are designed to supplement provisions in the law or provide a means for carrying them out.[7] The issuance of this Circular indicated the OFC's determination to press ahead with its mandate to enforce the existing laws by detailing a regulatory framework for competition enforcement through which it would interpret the existing fragmented legal provisions. The introduction of the new law refers to the repeal of the Guidelines, which is unsurprising given the inconsistencies between the Guidelines and the new law. Nevertheless, the Guidelines have provided a clear and concise explanation of different types of anti-competitive practices during the interim period before the law takes effect and the new Commission is established. Aspects of the OFC's Guidelines and the process of developing them could usefully inform the development of the new law's implementing rules and regulations, which the new Commission will draft in consultation with the Department of Justice and Office for Competition.

The competition regime

This section will review the competition laws and institutions that existed prior to the adoption of the 2015 *Competition Act* (RA 10667), and will assess the provisions in the new competition law.

The competition law

Objectives and scope:

The Constitution sets out the basic Philippine policy on competition. Article XII (19) states: "The State shall regulate or prohibit monopolies when the public interest so requires. No combination in restraint of trade or unfair competition shall be allowed". The provisions of the existing *Revised Penal Code* 1932 apply to goods and services but are only applicable to individuals, not economic entities. This and the other legislative acts under the previous regime covered combinations in restraints of trade as well as unilateral acts such as monopolisation, stockpiling and profiteering.

Competition policy objectives in the new *Competition Act* are set out in Chapter 1 (2a-c). Section 2(a) refers to enhancing economic efficiency and promoting free and fair competition in trade and all economic activities, and makes specific reference to the establishment of a National Competition Policy that is to apply across government agencies. The law also makes specific reference in Section 2(b) to the objective of preventing market concentration that controls production, distribution or trade that would unduly threaten to distort competition in the Philippines. Section 2(c) refers to the penalisation of anti-competitive practices and mergers with the objective of protecting of consumer welfare and advancing domestic and international trade and economic development.

The *Competition Act* applies to good and services and legal persons, individuals and economic entities. Under Chapter 1 (4), “entity” is defined to include those “owned or controlled by the government”, engaging “directly or indirectly in any economic activity”. State-owned enterprises therefore appear to fall within the scope of the Act. Its provisions apply to acts committed domestically or abroad that are likely to affect the trade, industry and commerce of the Philippines.

Exclusions and exemptions:

No sector of the economy is exempt from the new competition law, but the law provides the new Competition Commission with unusually broad exemption powers. Chapter 5 (28) enables the new Competition Commission to exempt an entity from the enforcement of the Act for a limited time if the Commission determines that enforcement is not necessary to attain the policy objectives of the law or that competition would not be impeded in the market where the entity operates or in related markets. While the exemption must be made public and may be conditional or subsequently withdrawn by the Commission, it provides for a high degree of discretion in its application without reference to standards or conditions and the timeframe is vague. The provision also gives wide discretion for the Commission to withdraw exemptions previously given, which is at odds with principles of procedural fairness. The fact that the exemption is designed for entities rather than a specific agreement or practice that meets particular statutory standards is surprising given that the economy is dominated by large conglomerates that operate across many different markets. It is understood that this provision was inserted in order to avoid legislative wrangling and business lobbying over exemptions for particular industries in the Congress, leaving it to the new Commission to assess and determine potentially many requests from businesses looking to exempt themselves entirely from the provisions of the Act. At a minimum a general procedure should be established to help avoid non-transparent and ad hoc responses to pressure for special interest and protection, as well as more detailed clarification of the grounds for exemption.

Moreover, there is a broad public interest exemption in the new law. Chapter 5 Sec 26(d) stipulates that it is for the Commission to weigh up whether on balance enforcement is necessary or whether it would amount to "overzealous or undue intervention" that would undermine competition efficiency, productivity, innovation or the development of priority areas or industries. Consequently even if the balancing is in favour of a prohibition, the Commission must consider the impact of enforcement on these macro variables. The Act stipulates that the Commission should consider wider public policy and national champion considerations, including: the overriding need to make the goods/services available to consumers, the need for large infrastructure investments and the need of the Philippine economy to respond to international competition (Section 26(c)). The law also directs the Commission to consider whether the entity's alleged anti-competitive conduct was done with a "reasonable commercial purpose", which could include phasing out a product or closing a business or a "reasonable commercial response to the market entry or conduct of a competitor" (Section 26(e)).

OECD jurisdictions have shifted away from the use of public interest objectives as part of competition law analysis. Most competition authorities do not consider factors that extend beyond what appear to be the generally accepted "core" competition policy objectives of promoting and protecting the competitive process, and attaining greater economic efficiency. Public interest exemptions are more prevalent in developing and transition countries. Possible explanations for this include greater influence of vested business interests in these countries and a more pressing need to promote one or more public interest objectives given the stage of economic development. Even so, competition authorities and national courts generally do not authorise or exempt agreements, decisions or practices on public policy grounds if they directly oppose core competition principles. Traditionally, if public policy considerations must prevail, competition law experts have argued that such externalities should be addressed through legislation or regulation rather than through a restriction of the competition enforcement powers of competition authorities. Moreover, competition authorities are probably not best placed to pursue public objectives other than efficiency objectives, since they are technical and non-elected public bodies.[8]

Content of the competition law

Prior to the enactment of the *Competition Act*, the legal provisions in the Philippines on competition were fragmented across different statutes and sector-specific regulations. The main provisions addressing anti-competitive behaviour were found in the *Revised Penal Code*. Article 185 prohibits and criminalises bid rigging in public auctions while Article 186 prohibits and criminalises combinations in restraint of trade and unlawful monopolisation. Article 186 will be repealed by the new *Competition Act*. Bid-rigging is also covered by Section 65(b) of the *Government Procurement Reform Act* (RA 9184) which provides for higher penalties.

With the exception of bid rigging and cartelisation, specific anti-competitive agreements were not expressly prohibited in the Philippines. Abusive practices were not expressly prohibited, other than predatory pricing which was unlawful in limited industries such as the downstream oil industry. Other than the *Price Act* and provisions for treble damages through civil penalties, the relevant laws were criminal and required a burden of proof beyond reasonable doubt. There was no merger control regime provided for in the law, although a review process to assess the competitive effects of mergers was recently introduced to the merger approval.

This legal framework for competition law complied with the minimum elements prescribed in the ASEAN Regional Guidelines on Competition Policy which provide a common framework for Member States introducing competition law in their respective national contexts. As a baseline, the guidelines suggest that the competition law should: (*i*) prohibit horizontal and vertical agreements between undertakings that prevent, distort or restrict competition in the Member State's territory, unless otherwise exempted – which would include hard core restrictions, such as price fixing, bid rigging, market sharing and limiting or controlling production or investment; (*ii*) prohibit the abuse of a dominant position; and (*iii*) prohibit anti-competitive mergers.[9]

The DOJ-OFC *Guidelines on the Enforcement of Competition Law* adopted on 15 May 2015 created basic prohibitions for anti-competitive agreements and abuse of a dominant position. It was not evident that these could be readily extrapolated from the existing laws at the time and therefore it was unclear to what extent a prosecution under the legal provisions could rely on the descriptions in the Guidelines of what constitute anti-competitive practices. In any event, given the criminal nature of these laws (other than the *Price Act* relating to cartelisation and monopolisation in commodities), the standard of proof required for the offences is beyond reasonable doubt, which would be difficult to prove under that legal regime. In addition the applicable sanctions were fixed by law.

The *Competition Act* contains the three major prohibitions identified in the ASEAN Regional Guidelines. It provides for mandatory criminal sanctions for both entities and individuals engaged in price fixing, bid rigging, market allocation and controlling output. Administrative fines can be applied for entities breaching the competition law. The law has no retroactive effect.

Restrictive agreements:

The distinction between horizontal and vertical agreements in the *Competition Act* is not as clear-cut as that provided in the OFC Guidelines which differentiated between horizontal and vertical agreements by providing examples. It is advisable for the implementing rules and regulations under the new law to do the same.

Article 186 of the Revised Penal Code 1932 (since repealed by the *Competition Act*) prohibited and criminalised the monopolies and combinations in restraint of trade, which comprised:

- A conspiracy or combination in the form of a trust or otherwise, in restraint of trade or commerce or to prevent by artificial means free competition in the market;
- Monopolising any merchandise or object or trade or commerce, or combining with any other person or persons to monopolise any merchandise or object, in order to alter the price thereof by spreading false rumours or making use of any other article to restrain free competition on the market;
- A combination, conspiracy or agreement between a manufacturer, producer, processor or importer and any other persons for the purpose of making transactions prejudicial to lawful commerce or of increasing the market price of any merchandise or object of commerce.

Various Supreme Court decisions have defined “combination in restraint of trade” and the acts that constitute a restraint of trade.[10] However no Supreme Court ruling has declared an entity to be involved in a combination in restraint of trade and no entity has been convicted under these provisions.

Anti-competitive agreements under Article 186 were illegal per se. Article 186 was a criminal provision and penalties were restricted to natural persons. The penalty provided for a prison sentence ranging from six months and one day to two years and four months, and a fine ranging from 200 to 6 000 pesos (approx. USD 4–134). The incredibly low fining range was set in 1932 and was never upgraded to reflect inflation. Compare this to fines in more established jurisdictions, which are typically up to 10% of worldwide turnover.

The *Revised Penal Code* also prohibits bid rigging in public auctions as a *per se* offence. The Article 185 prohibition includes both attempted as well as actual collusion in public procurement. It carries the same criminal penalty of a prison sentence as Article 186 offences, along with a fine ranging from 10-50% of the value of whatever is auctioned. Bid rigging is also prohibited under the *Government Procurement Reform Act* (RA 9184), with a criminal sanction of 6-15 years' imprisonment for individuals, including public officials, who engage in bid rigging.

Section 5 of the *Price Act* 1992 prohibits cartels designed to manipulate the prices of basic necessities and prime commodities[11]. Its objective is to keep the prices of these goods at reasonable levels especially during times of "calamity" and "emergency". It provides for extensive price monitoring and price setting powers. The Act is enforced by various agencies, in respect of the particular goods that fall under their respective jurisdictions, although the Department of Trade and Industry (DTI) is the primary implementing agency. It can impose prison sentences of 5-15 years with fines of between 5 000 and 2 million pesos (approximately USD 110 – USD 45 000) and administrative fines of between 1000 – 1 million pesos (approximately USD 22 – USD 22 000) and other penalties (such as cease-and-desist orders and closure of establishments). The *Price Act* therefore provided a potentially important avenue to deal with price fixing across a range of commodities, although the cartel offence has never been enforced.

Section 11 of the *Downstream Oil Industry Deregulation Act* 1998 prohibits cartelisation in the downstream oil industry. The Act was a response to the power supply crisis in 1992 and was intended to liberalise the downstream oil importation, refining and distribution industry in order to attract new players and investment. The Act abolished the power of the government to set oil prices or regulate competition in the market, but it included provisions prohibiting collusion and predatory pricing to prevent anti-competitive distortions. Criminal sanctions apply for cartelisation under the Act of three months to one year imprisonment and a fine ranging from 50 000 – 300 000 pesos (approximately USD 1 120 – USD 6 700). Deregulation did not result in a more competitive market however, and additional measures are needed to encourage more investment and new entrants as well as investment in the alternative energy sources in the upstream market.[12]

The OFC 2015 Guidelines, distinguished between horizontal and vertical agreements. They provided a non-exhaustive list of different horizontal restrictions categorised as hard core cartels, including price fixing, output restrictions, market allocation and bid rigging. They also contained a detailed but non-exhaustive list of vertical agreements that are considered anti-competitive (Chapter 2, Sec 2). The latter includes resale price maintenance, agreements to discriminate, tying, boycotts, exclusivity deals, restrictions on passive sales and certain forms of selective distribution. In most jurisdictions, boycotts and tying are associated with monopolisation or abuse of dominance, not vertical restrictions. Here, the Guidelines listed tying and refusal to deal also under exclusionary abuses in Chapter 2 Sec 3.

The first cartel case was filed in November 2011 against liquefied petroleum gas dealers for alleged price fixing in breach of Article 186 of the Revised Penal Code and the *Downstream Oil Industry Deregulation Act* of 1998. In 2014 the case was reported as under motion for reconsideration, but no further details are available. An investigation into alleged price fixing among power generation companies was opened following complaints received in December 2013. The on-going investigation is being separately undertaken by both the Energy Regulatory Commission and the OFC, with co-ordination between the two agencies.

The rule on anti-competitive agreements in Chapter 3 Section 14 of the new *Competition Act* is a mix of the *per se* and rule of reason approaches. This hybrid approach was a compromise to align the House version of the law, where all anti-competitive agreements were *per se* illegal, with the Senate version, which had a rule of reason approach. The Act prohibits three categories of agreements: (i) agreements between competitors concerning price fixing and bid manipulation are *per se* illegal (Chapter 3, Sec 14(a)); (ii) agreements that specifically relate to controlling production and market sharing that have as their object or effect the substantial prevention, restriction or lessening of competition (Chapter 3 Sec 14(b)); and (iii) all other agreements (regardless of subject matter) that have as their object or effect the substantial prevention, restriction or lessening of competition. In relation to this third category, there is an exemption similar to the EU system whereby the agreement may be exempted if efficiencies outweigh the anti-competitive effect by improving production or distribution of goods or services while allowing consumers a fair share of the benefits (Chapter 3 Sec 14(c)).

The Act therefore adopts the language and style of both US (*per se*) and EU (object or effect) concepts, but it is silent on whether the Commission, if it identifies "*per* se" infringements or infringements "by object", need only establish the existence of the prohibited agreement without having to analyse its effect on the market. The Act defines anti-competitive agreements as agreements between competitors. Therefore the prohibition in Chapter 3 Section 14 applies only to horizontal agreements and not to vertical agreements. Vertical agreements can still fall under the prohibition of abuse of dominance.

Box 4.3. **OFC cartel investigations and studies**

Garlic price increase (September 2014)

The DOJ-OFC was instructed by the President to investigate price hikes of garlic after prices in June 2014 rose to an all-time, increasing 74% within a one year period or more than 100% increase from average prices. The OFC's report noted that there was adequate supply and stocks of garlic. It found that the majority of import permits (imports represent 73% of supply) issued were granted to one group. The permits were ostensibly for the purpose of checking garlic quality but they enabled a group of four individuals to obtain most of the import permits, cartelise the market and charge higher prices. The OFC examined a similar case investigated by the Indonesian competition authority in the Indonesian garlic market. The DOJ-OFC report recommended a number of actions to be taken, including: abolishing a government-instituted action team that was deemed to contribute to the problem, investigating and prosecuting certain individuals, and establishing a fair and transparent system to allow for competition in the industry, including the removal of the current import permit system. The National Bureau of Investigation subsequently filed criminal charges under the Anti-Graft and Corrupt Practices Act against 119 individuals for cartel conduct in the garlic industry.

Onion report (January 2015)

Off the back of the garlic investigation, the DOJ-OFC examined data on the onion industry and found that the same practices identified in the garlic cartel were being used to manipulate onion supply and prices by the same group of alleged cartelists. The report recommended the abolition of the current import system as well as the government mandated task team. The OFC also proposed that the commodity sector should be prioritised for competition-related studies and prepared a draft Administrative Order for the President to direct all heads of departments, bureaus, commissions, agencies and offices engaged in sector regulation, particularly those involved in regulating basic necessities and prime commodities, to conduct sector studies to determine possible competition reforms.

ATM fees and charges (October 2013)

The OFC issued a statement cautioning banks on industry-wide adjustment ATM fees and charges. The statement pointed out the need to increase transparency in the imposition of interbank withdrawal charges to ensure that there is no coordinated action among banks, which is considered anti-competitive.

Criminal sanctions are reserved to price fixing and bid rigging as *per se* offences (Chapter 3 Section 14(a)), and for market allocation and controlling output as by object or by effect offences. Accordingly, the Commission can impose administrative fines on the entity but will have to refer criminal prosecution of entities and individuals to the DOJ-OFC. Consequently the standard of proof for civil cases on anti-competitive agreements will be different from criminal cases, which will require proof beyond reasonable doubt.

Abuse of dominance:

Article XII (19) of the Constitution provides that the State shall regulate or prohibit monopolies when the public interest so requires. Therefore it does not prohibit monopolies *per se* but requires a previous determination as to whether the public interest warrants a monopoly. This interpretation was confirmed by the Supreme Court.[13] Article 186(2) of the *Revised Penal Code* (repealed by the new *Competition Act*) sanctioned "any person who shall monopolise any merchandise or object of trade or commerce". It also prohibited monopolies without exceptions. The sanctions were the same as those listed in the section above for restrictive agreements. None of the applicable provisions refer to a dominant position.

A special regime exists for the energy sector. Under section 45 of the *Electric Power Industry Reform Act* 2001 the Energy Regulatory Commission (ERC) is tasked to enforce safeguards against anyone owning, operating or controlling more than 30% of the installed generating capacity of a grid, or 25% of the national installed generating capacity. It also prevents distribution utilities from sourcing from bilateral power contracts more than 50% of their total demand from an associated firm engaged in generation. The ERC is mandated to monitor and penalise any market power abuse or anti-competitive or discriminatory act or behaviour in the electric power industry.

The *Price Act* prohibits "hoarding or the undue accumulation of prime commodities beyond normal inventory levels"; and profiteering or selling "at a price grossly in excess of the good's true worth" (Section 5). These prevent abusive price increases of basic necessities and prime commodities. The applicable sanctions are the same as those for price collusion, detailed in the section above.

Box 4.4. **Philippine Supreme Court rulings on monopolies**

Agan vs. Philippine International Air Company, et al.: The Supreme Court defined monopolies as "a privilege or peculiar advantage vested in one or more persons or companies, consisting in the exclusive right (or power) to carry on a particular business or trade, manufacture a particular article, or control the sale of a particular commodity".

(GR No. 155001 5 May 2003)

Gokongwei v Securities and Exchange Commission: The Supreme Court upheld the validity of a provision in the by-laws of a corporation that would disqualify any stockholder from being nominated to its board of directors when he is engaged in a competing business, citing the prohibition on monopolies contained in the Constitution and Article 186 of the Revised Penal Code. It further explained that "a common director of two or more competing corporations would have access to confidential sales, pricing and marketing information and would be in a position to coordinate policies or to aid one corporation at the expense of another, thereby stifling competition."

(GR No.L-52129 29 April 1980)

The *Downstream Oil Industry Deregulation Act* prohibits predatory pricing, defined as "selling or offering to sell any oil product at a price below variable cost for the purpose of destroying competition, eliminating a competitor or discouraging a potential competitor from entering the market" (Section 11(b)). Pricing below average variable cost in order to match the lower price of a competitor and not for the purpose of destroying competition is not deemed to be predatory pricing.

The DOJ-OFC 2015 Guidelines provide extensive detail in a non-exhaustive list of the elements that may be considered in determining dominance, in addition to market shares (Chapter 2 Sec 3(1)). The inclusion of a reference to entities that are dominant by virtue of exclusive rights to provide a service or supply for essential public services, specifically included incumbents in the regulated sectors within the OFC's remit. The Guidelines also provide an extensive list of conducts that may be considered abusive, which are delineated into exploitative and exclusionary abuses. This list provides a brief description of each abuse, but does not go so far as to provide guidance on the analytical framework the OFC will use to assess conduct. Nevertheless, this may be a useful starting point in the development of the relevant implementing rules and regulations for the new Act.

The new *Competition Act* abuse of dominance prohibition in Chapter 3 Sec 15 broadly reflects the EU system. It prevents the abuse of a dominant position by one or more entities and sets out a list of potentially unlawful abusive conducts, although it is not clear whether or not the list is intended to be exhaustive. In assessing the relevant market, the Act adopts an approach that mirrors other regimes, focusing on substitutability.

A number of features of the law relating to abuse of dominance differ from international best practice. First, Chapter 5 Sec 27 establishes a rebuttable presumption of dominance if the market share of the entity in the relevant market is 50% or more. Although not unique in comparison with other jurisdictions, this is not in line with a growing acceptance that market shares are not necessarily a useful proxy for substantial market power. Even where jurisdictions have stipulated through guidance and case law that a particular market share may indicate dominance, it is clear that market shares are not the only element on which dominance is generally assessed. Although Chapter 5 Sec 27 provides additional elements for the Commission to consider when assessing dominance (including the existence of barriers to entry, the existence and power of its competitors, the power of its customers to switch to other goods or services and the recent conduct of the entity), it is not clear how this will interact with the market share threshold and whether the latter would suffice to establish dominance without robust evidence of durable market power. Second, the law also provides for the Commission to set market share thresholds for dominance for particular markets. Different threshold presumptions in different markets are likely to result in legal uncertainty and will undermine the benefit usually associated with a "rule of thumb" market share presumption for dominance.

The conducts listed in Chapter 3 Sec 15 as abusive practices broadly reflect those usually found in the laws of other jurisdictions: predatory pricing, imposing barriers to entry, tying, price discrimination, sales or purchasing conditions, exclusive dealing, limiting production and non-compete clauses, although again it is not clear if this is intended to be an exhaustive list. It also prohibits "unfair pricing" and prohibits the purchase of goods at unfairly low prices from marginalised agricultural producers, fishermen, MSMEs and other marginalised service providers and producers.

The description of predatory pricing includes a controversial exemption for prices established "in good faith". It is understood that this exemption, which is not found in the competition laws of other jurisdictions, was removed from the House version of the Bill following debates over the potential for it to be used as an "escape clause" by dominant companies to resort to predatory pricing in the guise of "good faith".[14] The clause was reintroduced at the bicameral discussion stage, despite arguments that selling below cost with the intention of driving out the competition is a prohibited act in itself and therefore, in bad faith.

Another feature of the Act's abuse of dominance provision is the inclusion of the potential for exemptions for price discrimination based on a list of permissible price differentials (Chapter 3 Sec 15 (d)). This includes "socialised pricing" for the poor, as well as reasons for different pricing structures, such as transport costs, but also responding to competitive prices or services of a competitor as well as changing market conditions. This level of detail would be more suited to a guidance document to fully explore what amounts to objective and proportionate reasons for price discrimination, based on efficiency grounds.

The Act makes specific reference that it will not be interpreted as prohibiting a dominant position or the acquisition of market share through "legitimate means" before the law was passed (Chapter 3 Sec 15(g)). Clearly the law should be about the abuse of a dominant position which should never be prohibited as such, so this point seems incongruous. Presumably the inclusion of the statement was to assuage any concerns that the law is anti-big business, given the continued resistance to introducing a competition law over the past 20 years.

As with the prohibition on anti-competitive agreements, conduct conferring an objective benefits, while allowing consumers a fair share of the resulting benefit, may be exempted from being considered an abuse of a dominant position (Chapter 3 Sec 15(i)).

Mergers

The old laws did not provide for a merger control regime. The Corporation Code 1980 (Sections 79 and 80) required mergers and consolidations of corporations to be approved by the Securities and Exchange Commission (SEC) but did not provide for the SEC to consider the anti-competitive effects or nature of the merger. Section 140 allowed the relevant agency to impose a maximum limit on stockholding in corporations whenever necessary to prevent illegal monopolies or combinations in restraint of trade. The SEC control mechanism was rudimentary and did not allow for the parties to amend the merger if in contravention of the competition provisions in different laws, and did not specifically refer to competition rules and objectives.

In the case of a merger or consolidation of entities subject to sector-specific regulations such as banks, insurance companies, public utilities and other corporations governed by special laws, approval had first to be obtained from the relevant government agency. For example the Energy Regulation Commission had the power to grant clearance to mergers under the *Electric Power Industry Reform Act* (EPIRA) provided that they did not have the effect of substantially lessening competition in the market. It could also authorise mergers if they were likely to result in a benefit to the public that would outweigh any detriment caused by a lessening in competition. Such benefits were defined as improved reliability of service, lower prices and more choice for consumers, increased economic efficiency, more efficient resource allocation, growth in employment and improvements in the quality and safety.[15] Section 45 of EPIRA sets market share thresholds that ring fence the transmissions assets from parties in the generation, distribution and retail markets in order to prevent vertical integration.

To encourage compliance with competition law and to address the lack of merger review, the DOJ and SEC agreed in July 2014 to set up the country's merger control regime based on existing provisions of law pending the introduction of a comprehensive competition law. The agreement, which took effect in August 2014, stipulated that all applications for approvals and consolidations must be forwarded to the OFC for evaluation and determination of the existence of any anti-competitive effects. The OFC would submit its findings and recommendations to the SEC. According to the agreement a finding by the OFC that a proposed merger or consolidation would result in a violation of existing laws on competition, monopolies or restraint of trade may lead the SEC to either disapprove the application or require the applicant corporations to comply with specified conditions within a prescribed period. The agreement provided for a 30 day time period from receipt of a complete set of documents for the OFC to carry out its assessment. The agreement was an important step towards implementing merger control in the Philippines and also highlighted the OFC's determination to move forward with its mandate to support and enable competition prior to the enactment of the *Competition Act*.

The OFC was in the process of drafting merger guidelines that were to cover the specific processes, requirements and standards it would apply to its merger assessments, but the guidelines have not yet been issued. To date, the OFC reports that ten mergers have been cleared and seven applications from the SEC are pending since the beginning of 2015. It is unclear on what basis the OFC's assessments are currently made, although it is understood that the OFC was not at the stage of applying technical analysis to its merger assessments. Delays in completing the assessments have been a cause for concern for parties and the SEC. The 30 day period set out in the MOA is counted from the time the OFC receives a complete set of documents from the SEC. Without a clear merger notification process, it is understandably difficult for parties to know what information is required of them, although the SEC provides a checklist of requirements to merger applicants. And while the final decision of the OFC was made available to the SEC and parties, it is good practice for competition agencies to publish decisions and assessments, redacted as necessary. This promotes transparency in the process and provides useful guidance to business on the agency's approach to merger review in practice.

The new *Competition Act* introduces a mandatory and suspensory merger control regime. The notification threshold is based on the value of the transaction, together with a requirement that control is acquired. This is in common with the majority of merger control regimes globally. Compulsory notification to the Commission is required for any merger or acquisition agreement with a transaction value exceeding one billion pesos (USD 21 million). Where this threshold is exceeded, parties are prohibited from completing their merger or acquisition until 30 days after submitting a notification. An agreement completed in violation of this requirement to notify shall be considered void and subject to an administrative fine of 1-5% of the value of the transaction. (Chapter 4 Sec 17).

The Act provides statutory deadlines for the merger review process. From the time it receives the notification the Commission has 30 days to review the transaction, which can be extended by a further 60 days, beginning on the day of the request, if the Commission requires additional information to make its assessment. The Act requires that the total period for the review of any case shall not exceed 90 days from the initial notification by the parties which is a much shorter timeline than a number of other regimes. The transaction is deemed approved if the Commission fails to make a decision within the above time periods. In the event of a clearance decision related to a merger in sectors covered by other sectoral laws, approval by the relevant government agency is required. The Act does not dispense with the favourable recommendation from specialised regulatory agencies (for example the Bangko Sentral ng Pilipinas) required by Section 79 of the Corporation Code.

Many elements of the merger system follow the EU model. The definition of control (Chapter 5 Sec 25) appears to be based upon the "decisive influence" criterion under the EU Merger Regulation. This definition will enable the Commission to target potentially problematic transactions more effectively, as it requires more case specific interpretation. The Act adopts the substantial lessening of competition test to assess mergers. Chapter 4 Sec 20 prohibits mergers "that will prevent or substantially lessen competition in the relevant market or in the market for substantially related goods or services". The enforcement model is therefore based on the EU administrative model. The relevant market is determined by a classical definition of product and geographic markets (Chapter 1 Sec 4(k)), and replicates the EU definition.

If the Commission finds that the merger will substantially lessen competition, it may: a) prohibit the agreement; b) require modification or amendments to the agreement; or c) require legally binding commitments (remedies) from the parties (Chapter 4 Section 21). The Commission may also approve a merger that would otherwise be prohibited for substantially lessening competition where it is likely to result in efficiencies that are greater than its anti-competitive effects or to avoid a failing firm exiting the market. In both cases the burden of proof rests with the parties (Chapter 4 Sec 21 and 22). Acquisitions of stock that do not carry voting rights or otherwise allow for the exercise of control are also explicitly exempted.

The Act appears to provide for administrative fines for a prohibited merger (Chapter 6 Sec 29(a)) which is at odds with standard practice around the world where penalties are limited to failure to comply with the notification requirement.

The detail of the merger regime will need to be set out in the Commission's implementing regulations. These should reflect that most mergers do not raise competition concerns and enable the Commission to deal with these swiftly and efficiently. At the same time, it needs to be capable of identifying potentially anti-competitive mergers, applying sophisticated analysis of markets and the effects of the transaction to determine whether the merger is anti-competitive or efficiency enhancing. Additional guidelines would provide advice and general information to companies and their advisers on the procedures used by the Commission. This should also include detailed information on the application of the substantive test that the Commission will use to assess mergers.

Unfair competition / consumer protection

References to unfair competition are made in the Constitution and the 1949 *Civil Code*. Article 28 of the *Civil Code* provides for civil damages to be sought by those that are subjected to unfair competition in certain industries: "agricultural, commercial, or industrial enterprises or labour". It does not define unfair competition but lists the means by which it can be committed: "force, intimidation, deceit, machination, or any other unjust, oppressive or highhanded method." Properly understood, the law of unfair competition is primarily comprised of torts – deceptive or wrongful practices – of a business that cause an economic injury to consumers or other businesses, as opposed to economic harms involving monopolies and anti-competitive practices.

The *Consumer Act* 1992 covers all consumer-related concerns. The DTI is empowered with rule-making and adjudicatory powers to ensure the effective protection of consumers.[16] It is mandated to enforce the provisions of the Consumer Act on deceptive, unfair and unconscionable sales or practices, the regulation of practices relating to weights and measures, consumer products and service warranties, labelling and fair packaging, liability for products and services, advertising and sales promotions and regulation of service and repair firms. The Department for Health covers consumer-related matters for food, drugs, cosmetics, devices and substances. The Department of Agriculture covers agricultural products. The National Consumers Affairs Council is the formal co-operation mechanism between the three government departments, and also includes the Department of Education, Culture and Sports as well as representatives from national consumer organisations and business/industry sectors. The National Telecommunications Commission also has consumer protection powers under its law.

The DOJ's mandate under the Law Prescribing the Duties and Qualifications of Legal Staff in the Office of the Secretary of Justice 1964 provides it with the jurisdiction to take criminal prosecutions under the Articles 185 and 186 of the *Revised Penal Code*, cartelisation under the *Price Act* or under the *Cheaper Medicines Act* and deceptive or unfair trade practices under the *Consumer Act*. The OFC's mandate under EO 45 gave it the power to enforce competition policies and laws to protect consumers from abusive, fraudulent, or harmful corrupt business practices. Consequently the OFC has been heavily involved in unfair competition cases in their broadest sense.

The OFC notes that it has prepared a draft study on the distinction between abuse of dominance, unilateral conduct and unfair trade practices which will form the basis of a Legal Opinion with a focus on key sectors such as telecommunications and air transport. It remains to be seen how such studies and opinions will influence the perspective of the new Commission in the application of the *Competition Act*.

To delineate jurisdiction between the OFC and the DTI, they agreed in July 2013 to implement a complaint handling system for violations of competition and consumer welfare laws. The DTI dealt with administrative cases involving individual consumer complaints, while the OFC dealt with business-to-business cases, as well as criminal and civil cases, although investigations are undertaken jointly with the DTI, where they are referred on. The majority of the OFC's actions to date are consumer-related cases involving unfair commercial practices. For example 22 of the 58 complaints the OFC has acted on have involved consumer complaints in the telecommunications sector. Most of these consisted of misleading advertising and unfair commercial practices and were referred to the DTI for action.

Box 4.5. **OFC activities on unfair business practices**

Statement on gift certificates – 13 December 2013

On the OFC's recommendation, the Secretary of Justice issued a statement that gift certificates including gift checks and gift cards are equivalent to cash and do not have an expiry date. This was intended to remind businesses and consumers of the relevant DTI's regulation prohibiting any supplier from issuing gift certificates/checks/cards that contain an expiry date.

Advisory on Airline ticket sales - 18 February 2013

This addressed misleading advertisements and promotional campaigns for air fares, which exclude material information from the advertisement. The DOJ-OFC reminded airline companies that they should refrain from misleading advertising and must include reasonable details to enable consumers to make informed decisions. The full price must be disclosed before the transaction is completed to avoid hidden or additional costs. Consumers are reminded to closely scrutinise deals and promotional offers.

Advisory on broadband and mobile internet services – 24 September 2014

This was issued following complaints from subscribers that they were not getting what they are paying for. The DOJ-OFC reminded Internet Service Providers (ISPs) that they must not use false, deceptive or misleading advertisements in promoting internet offers. ISPs must provide all the necessary details in their advertising including, service rates, minimum connection speed, and service reliability. It calls on relevant regulatory agencies to monitor, enforce and implement sanctions on erring telecom companies under the *Consumer Act* and the *Public Telecommunications Policy Act*. It also reminds the general public to be critical about advertisements and to be prudent when subscribing to contracts.

Advisory on "unlimited" internet offers – 9 December 2014

This was issued following a complaint to the OFC about a promotional offer by a telecom operator marketed as unlimited access to Facebook. The OFC found that telecoms companies were imposing fair usage policies on all their internet packages including unlimited internet promotions. The advisory warned the operators that restricting subscribers' internet usage upon reaching a certain volume of data bits could amount to misleading or deceptive advertising when the packages were sold as "unlimited". It encouraged ISPs to adopt network management schemes that advance optimal use of the internet rather than restricting it, and advised that ISPs should offer internet packages specific to data usage, subscription period and/or software applications. Consumers are encouraged to be responsible and limit large data usage during peak hours and switch off broadband devices when not in use to free up the network. The advisory calls on the Department of Trade and DTI and NTC to monitor and penalise non-compliant telecom operators.

The OFC took the step of producing advisory opinions on matters where it received significant or a large number of consumer complaints. Even if the cases were referred on to other government departments for investigation, the OFC used the advisory opinions to detail and raise awareness of the misleading or harmful practice, remind business of their obligations under the relevant laws and call on the relevant government agency or regulator to monitor the practices and take enforcement action as appropriate. The opinions were not legally binding but they have provided a useful advocacy tool for business, regulators and consumers.

Institutional arrangements

The Philippine Competition Commission established under the *Competition Act* will be the country's first full-fledged competition authority. Until its establishment, various laws empowered different agencies to enforce the competition provisions under their respective legislation and regulations.

Office for Competition

The establishment of the OFC as the competition authority in 2011 through EO 45 was a significant step in developing an economy-wide competition regime in the Philippines. The OFC has made remarkable progress in getting itself on the map domestically and internationally in a short space of time. It is even more impressive that it has done so without any new legislative tools and in the absence of effective enforcement powers. The OFC was set up in October 2011 and sits under the Office of the Secretary of Justice. Both the DOJ and the OFC are under the Executive branch, headed by the President. Neither the DOJ nor the OFC are structurally independent agencies; they are under the responsibility and oversight of the Secretary of Justice.

The OFC is headed by an Assistant Secretary. At the outset, there were only two full time State Counsels and two technical assistants. The rest of the 20 staff were part time and continued with their pre-existing duties from the offices to which they were attached: the National Bureau of Investigation[17], DOJ Legal Staff, Office of the Solicitor General[18] and Office of the Government Corporate Counsel[19]. Initial needs-assessments conducted for the OFC highlighted the importance of a dedicated and trained staff.[20] More full time positions were appointed in 2012. In 2015 there were 22 full-time lawyers, economists, investigation agents and support staff as well as 20 assisting lawyers.[21]

Table 4.2. **Existing institutions with competition responsibilities**

Government agency	Competition remit
Department of Justice **Office for Competition**	• DOJ investigates and prosecutes crimes, including Article 185 and 186 of the Revised Penal Code; cartelisation under the Price Act and Cheaper Medicines Act. • DOJ designated the competition authority in 2011. • OFC created in 2011 to enforce competition policies and laws to supervise and promote competition in markets in order to protect consumers from abusive or harmful business practices. Tasked with investigating and prosecuting cases involving violations of competition laws. Promotes transparency and accountability in markets by conducting and disseminating sector studies, reports and other relevant issuances. Tasked with promoting international cooperation and strengthening trade relations with other countries. • Neither DOJ nor OFC can impose criminal or other fines and penalties – this is a matter for the regular courts. Nor are they authorised to issue cease and desist orders or injunctions against alleged violations of the existing competition laws
Department for Trade and Industry	• Primary implementing agency of the Price Act in relation to certain basic necessities and prime commodities: conduct investigations and impose administrative penalties and other penalties; may initiate civil actions and initiate criminal violations with the regular courts
Securities and Exchange Commission	• Approves mergers and consolidations of corporations; Memorandum of Agreement with OFC on competition assessment of mergers and acquisitions
Joint Task Force of DOJ and Department of Energy	• Oversees competition in the downstream oil sector: investigate complaints about cartelisation and predatory pricing and direct DOJ criminal prosecutors to initiate actions before the regional trial courts. It does not have the power to impose fines or penalties for violations of the Downstream Oil Deregulation Act
Energy Regulatory Commission	• Principal regulator for the electric power industry under the Electric Power Industry Reform Act. Responsible for issuing rules and regulations to promote competition, encourage market development and consumer choice; it has published competition rules relating to the identification and investigation of anti-competitive behaviour in the sector. Tasked with monitoring and penalising abuse of market power, cartelisation and any anti-competitive or discriminatory behaviour. It has the power to impose remedies to redress these violations *e.g.* price controls, injunctions, divestiture or disgorgement of excess profits, fines and penalties

The OFC's budget is allocated as a separate regular item in the *General Appropriations Act*. The OFC's operational budget in 2012 and 2013 was 7.525 million pesos (USD 168 000). This was increased to 10.144 million pesos (USD 226 600) and 11.86 million pesos (USD 265 000) in 2014 and 2015 respectively.

The current OFC structure provides for both lawyers and economists in dedicated divisions, as well as investigators in the enforcement division. It was recognised early on that in addition to full time personnel, there was a need for expert economists. This point will be equally relevant for the new Commission. The OFC plantilla has a balanced mix of lawyers with business, economics and political science backgrounds as well as economists assigned to different divisions – Legal, Enforcement, Market Assessment, and Economics Divisions. The OFC has National Bureau of Investigation staff detailed to it in a bid to build investigation capacity.

Training of staff by foreign experts has been key and continues. The OFC has taken advantage of training programmes through partnerships with development organisations and international organisations, as well as bilateral capacity building provided by established competition agencies. The OFC has extended these programmes to include officials from sector regulators, other government agencies, the judiciary, business and law students. This supports its efforts to raise awareness and understanding across a broad range of stakeholders.

The OFC made co-operation with sector regulators and other government agencies a priority from the outset. It set up the Sector Regulators Council, which provides a means of sharing information and experiences and as well as an advocacy channel for the OFC to educate other government agencies about competition law and policy and to encourage those agencies with competition enforcement powers to deploy them. The OFC has been effective in corralling other agencies into conducting joint investigations on matters under their remit.

The OFC also established four working groups with leads from key stakeholders. The working groups themselves were primarily a means of fostering a collaborative environment with those counterparts.[22] They have been credited with smoothing the way for the adoption of the OFC's 2013 and 2014 Policy Paper discussing the respective roles and functions of sector regulators and competition agencies.[23] These made the case for concentrating competition powers in the competition authority rather than sector regulators, arguing that a competition authority is less prone to regulatory capture and is therefore better able to embed principles of principles independence, transparency, and accountability.[24] The new law reflects this position but does not detail how the new Commission and the regulators will interact in practice.

Good governance and integrity have been a strategic focus for the OFC. Developing and embedding a series of core values was particularly important for the OFC as a new agency, given the levels of perceived corruption and inequality in the Philippines. Accountability is important in this context and a systematic approach to making information publically available and readily assessable would support this effort. This should include publishing all studies and reasoned decisions on its website, as well as draft consultations and guidelines to raise awareness, improve dissemination and encourage more open consultations. These principles and good practices will be equally relevant for the new Competition Commission. Transparency provisions are embedded in the Act (Chapter 9 Sec 52) which requires the Commission to publish its final decisions, orders and rulings on its website, subject to confidentiality provisions (Chapter 7, Sec 34).

Before the *Competition Act* was approved, the OFC set out an ambitious set of priorities for the next two years. The OFC flagged the energy, transport and telecommunications sectors as priority areas where competition policy should play an important role in further regulatory reforms, and it anticipated studies for each. Additional policy papers were envisaged on emerging enforcement issues as well as study on the different roles of civil, administrative and criminal systems, and a framework for competition advocacy. The OFC had planned to conduct competition assessments and prepare reports in collaboration with the sector regulators and to continue to prepare advisory opinions on consumer protection concerns. A key priority was recruiting additional permanent staff.

Most of the functions of the OFC will transfer to the new Competition Commission leaving the OFC with a mandate focused on conducting preliminary investigations and prosecution of all criminal offences under the *Competition Act* and other competition-related laws. Nevertheless, the priorities that the OFC identified are likely to inform the new Commission's priorities. A mechanism is required to capture the knowledge, experience and methodologies that the OFC has developed to avoid re-inventing the wheel. It would also make sense to enable staff to easily transfer to the new authority, where they could play a key role in disseminating learning and institutional capacity building.

Although the OFC will no longer be the competition agency, it will continue to have the authority to investigate and prosecute criminal offences under the *Competition Act* and other competition laws (Chapter 2 Sec 13). However, the OFC in this new format will not be able to file a criminal case unless there has been an inquiry conducted and it has been endorsed to the DOJ (via the OFC) by the new Commission (Chapter 7 Sec 31). The Act provides for the OFC to grant leniency or immunity in the course of its preliminary criminal investigations in accordance with the leniency programme that will be developed by the new Commission. This will require close co-ordination between the OFC and the Commission to avoid confusion in a programme that relies on predictability in order to be effective in encouraging whistle-blowers to come forward.

Even though the Act does not prescribe a wider role for the OFC, for example to conduct advocacy or studies, there is a willingness on the part of the OFC to make use of its expertise to continue to promote the role of competition law in the national economic agenda. It would rely on the wider mandate of the DOJ as the government's law agency to advocate for legal and regulatory reforms in this area.[25]

Philippine Competition Commission

The Competition Commission is described in the *Competition Act* as an independent quasi-judicial agency (Chapter 2 Sec 5). It will be attached to the Office of the President for the purposes of budget (under the *General Appropriations Act*) and policy co-ordination. Over the years the bills have varied significantly on the institutional arrangements for the new Commission. Some draft versions of the law proposed an office under the Department of Justice, much like the current structure but with legal powers. The Act provides for a structure akin to the US model, with an independent Commission and an office under the Executive responsible for criminal enforcement under the new law and other related competition laws.

The Commission will consist of a Chairman and four commissioners who will be appointed by the President and rank as Secretary and Under Secretaries. They will have security of tenure and cannot be removed without just cause, which will support the independence of the Commission. They will hold office for one seven year term (non-renewable). One of the Chairman or the four Commissioners must be a member of the Philippines Bar, while another must be an economist. The others must have backgrounds in economics, law, finance, commerce or engineering from the public, private or academic sectors. The Executive Director of the Commission will be appointed by the Commission.

The Commission will report to a Congressional Oversight Committee on Competition to oversee the implementation of the law, jointly chaired by, the chairmen of the relevant Senate and House Committees, and composed of two senators and two representatives nominated by the Senate President and the Speaker of the House of Representatives, one of each of these nominations must be made by the Minority Leaders of the House and Senate.

The Commission will receive an initial budget outlay of 300 million pesos (USD 6.7 million) (Chapter 9, Sec 50). This is a significant budget increase from the draft versions of the law. In line with the majority of competition authorities around the world, the fines imposed by the Commission will not form part of the Commission's budget, but will be remitted to the Treasury. This is a welcome step and avoids the potential for regulators to be incentivised by collecting fines rather than seeking to promote effective competition, which would undermine confidence in the fairness and equity of the system. A robust funding model and institutional independence will stand the new Commission in good stead in terms of perception of independence from political interference.

The Commission will have primary jurisdiction over competition matters (Chapter 7 Sec 32). It will have jurisdiction over matters that involve both competition and non-competition issues, although the Act states that the relevant sector regulator will be consulted. The decisions, rulings and orders of the Commission will be appealable to the Court of Appeals (Chapter 7 Sec 39).

The Commission is to be established with 60 days of the Act coming into effect on 17 September 2015. The Commission is therefore expected to be in place by 16 November 2015. The implementing rules and regulations are due to come into force within 180 days of the law coming into effect – *i.e.* 15 March 2016. These are ambitious timeframes to set up a new agency, select and appoint a Chair, Commissioners and Executive Director, as well as draft the detailed implementing regulations envisaged throughout the Act.

The Act provides for a two year transition period before the prohibitions come into force once the law comes into effect (Chapter 9, Sec 53). This addresses concerns that business should have a reasonable timeframe to adapt to their new legal responsibilities under the Act. During this period the government is tasked with undertaking advocacy to inform the general public about the Act (Chapter 9, Sec 53).

Enforcement process and investigation powers

Under the previous competition regime, the OFC could begin an investigation in three circumstances: on its own initiative; as the result of a complaint; or pursuant to a request from a government agency. The National Prosecution Service of the DOJ conducts investigations of criminal violations under the Revised Penal Code and other laws with criminal penalties. The sector regulators, in exercise of their administrative powers generally conducted their investigations as the result of a complaint or on their own initiative.

The procedures for the OFC's investigations were set out in a Departmental Circular issued in March 2013.[26] The OFC issued a user-friendly version of the Guidelines for the public, including a flow-chart of the process, on 22 May 2015.[27]

Accordingly, the OFC conducted a preliminary assessment of all complaints received or own cases initiated to determine jurisdiction and the necessity of further investigation. The OFC could reject a complaint or close an investigation at this stage if there was no valid cause for action, or could refer the case to the appropriate sector regulator. No timeframe was set for the preliminary investigation stage. This "triage" stage would have benefitted from prompt handling of these matters to help move cases along more quickly. This is a useful read-across for the new Commission when it determines its case handling processes.

An investigation could be opened on the approval of the OFC Head and, according to the Guidelines, the OFC "shall conduct investigation within 90 days of the approval by the Head". The new Case-Handling Procedures, on the other hand suggests that the case was to get underway within 90 days of approval being granted. The OFC could request information and the Guidelines provided a ten day deadline for respondents to reply to a request for information, which could be extended by an additional ten days. It could conduct searches of premises subject to securing a search warrant from the courts. The Guidelines set out a template for the investigation report. The report could recommend three courses of action: (*i*) filing the case with the appropriate agency (administrative cases go to the relevant government agency; civil cases filed with the court with competent jurisdiction; criminal cases are filed with the National Prosecution Service of the DOJ for preliminary investigation); (*ii*) requiring the complainant to provide additional information; (*iii*) dismissing the case.

Once an investigation was completed, the report was approved by the Head of the OFC and submitted to the Secretary of Justice within 30 days of the end of the investigation. The Secretary of Justice could approve, modify or reject the OFC's recommendations and/or order a re-investigation. If the Secretary recommended the filing of administrative, civil and/or criminal charges the OFC had 15 days to prepare and file the complaint.

Individual investigations vary in complexity and length of time, and most competition authorities enjoy significant discretion as regards procedural timelines for enforcement. That said, some competition agencies have introduced statutory deadlines for different parts of the competition process, while many agencies have made commitments to speed up the process. According to the OFC, of the 58 cases docketed since 2012, 13 are pending preliminary assessment or at the investigation stage. In light of the timeframes set out above, this suggests that the OFC's investigation process has taken longer than envisaged, which is a point for the new Commission to consider when setting internal and/or external timeframes for its investigations.

This underscores broader points of relevance for both the OFC in its new role to conduct all criminal investigations and for the new Commission. There is a need for appropriate staffing levels to deal with caseload, and there is scope to prioritise case work to concentrate resources on high-impact or high-significance cases and projects, notably potentially harmful conducts, precedent-setting cases, significant market studies and advocacy projects on critical concerns. Many OECD countries' competition authorities have prioritisation principles, which help the authorities to better focus their resources and actions.

The new Competition Commission will have a broad range of powers and functions, which are detailed in Chapter 2 Sect 12 of the Act. The Commission will conduct inquiries, investigate, and hear and decide on cases involving any violation of the *Competition Act* and other existing competition laws. It can do so on its own volition, as a result of a complaint from an interested party or on referral from a regulatory agency. It can then begin the appropriate civil or criminal proceedings.

The Commission has also been given an advisory function. It can issue advisory opinions and guidelines on competition matters; submit annual and special reports to Congress, including proposed legislation for the regulation of commerce, trade or industry. The Commission will also monitor competition in the Philippine economy, implement and oversee measures to promote transparency and accountability, and ensure compliance with prohibitions and requirements of competition laws.

The Act sets a 90 day time limit on preliminary investigations after which the Commission must either terminate the investigation with a resolution stating that there has not been any violation or infringement, or issue a resolution to proceed to a full investigation. (Chapter 7 Sec 31). No deadline is stipulated for the full investigation. The Commission also has the power to issue a temporary cease and desist order during the course of its preliminary investigation. The Commission can file a criminal complaint before the DOJ-OFC, and its preliminary investigation will be conducted in accordance with the Revised Rules of Criminal Procedure.

It will be able to issue subpoenas for documents and testimony of persons and summon witnesses (Chapter 2 Sec 12(f)). The wilful failure to comply with a subpoena without just cause, as well as, for example, refusing to answer questions or furnish information when legally required to do so will be deemed contempt which may be summarily punished by the Commission by imprisonment for no more than 30 days or a fine, or both (Chapter 7 Sec 38). The Commission will have the power to conduct inspections subject to a court order (Chapter 2 Sec 12(g)). Many jurisdictions require a warrant from a court to conduct an unannounced inspection.

In common with most jurisdictions, the Act provides for a leniency programme to be developed by the Commission, which will grant an entity immunity from suit or a reduction in fine in exchange for the voluntary disclosure of information regarding cartels (Chapter 7 Sec 35). Complete immunity will be granted if the entity reports, in full, the illegal anti-competitive activity before the Commission initiates an investigation, and continues to co-operate throughout the investigation. It must not be the ringleader of the cartel, and it must have taken prompt action to terminate the illegal activities as soon as it identified them. The applicant may be granted leniency if the investigation has already started, if the entity co-operates fully and it is the first one to come forward for leniency, and if the Commission does not have sufficient evidence to convict the entity. The Commission must also decide that the granting of leniency would not be unfair to others. As mentioned above, the OFC will also be able to grant leniency in its preliminary investigations of criminal violations, and it will be necessary to ensure consistency in how leniency is applied across the two agencies. Details about possible reductions in fines for leniency applicants are not contained in the Act, and presumably this will be specified in follow-on implementing rules and regulations.

Sanctions and remedies

The *Competition Act* contains a set of wide-ranging, non-adjudicatory administrative remedies that the Commission may deploy; a number of which are atypical in light of international practices. Chapter 7 Sec 37(a) provides for a request for a binding ruling, akin to the US business review request for parties concerned about the legality under the competition laws of proposed business conduct. An entity will have 90 days to abide by the ruling in the event of an adverse ruling by the Commission. The provision for a "show cause order" in Chapter 7 Sec 37(b) suggests that the Commission can send a type of request for information to the entity about alleged anti-competitive behaviour and order that it rebut a finding of infringement, but it is unclear what evidence the Commission will provide to the entity. The entity can either propose to modify or restructure its acts to make them compliant with the law or it may provide justification as to why it should not be made to cease and desist from its conduct. Alternatively the entity may pay the administrative fine. Section 37(c) on consent judgements appears to provide for the Commission to enter into settlement agreements with the party, but the provision does not require admission of guilt, which suggests it may instead be a commitment decision process. The use of settlements typically applies to cartel investigations; they establish a violation and require an admission of guilt from the parties. A commitment decision does not establish a violation and does not require any admission by the parties; they are appropriate for all antitrust cases except for cartels. Therefore it is unclear whether this provision intends to introduce a settlement process or enable commitment decisions.

The text of the Act removed a provision from an earlier draft that included a consultation process for the parties prior to a binding rulings or consent orders. This would have embedded procedural fairness principles into the Commission's procedures. The inclusion of a monitoring function in Section 37(d) is unusual outside of merger control. Generally the competition authority only ensures that the fine is paid. This monitoring requirement risks being resource intensive and potentially detracting the Commission from enforcement activities and priorities.

A number of sanctions and remedies are envisaged for a violation of the prohibitions on anti-competitive agreements and abuse of a dominant position. They include imposing injunctions and orders for the disgorgement of excess profits. The Act also provides for structural remedies such as adjustment and divestiture orders, provided that there is no equally effective behavioural remedy or where such a remedy would be more burdensome for the entity concerned. It would be unusual to require structural and behavioural remedies to anti-competitive agreements. Structural remedies in abuse of dominance cases may involve significant up-front administrative costs and the risk of impairing the efficiency of the divested operations, as well as being interventionist with a remedy that attacks the dominant position rather than necessarily remedying the abuse.

The new Commission will also be empowered to impose certain administrative fines and penalties for violations of the proposed law (Chapter 6). The fines range from 100 million pesos (USD 2 million) for the first offence, to up to 250 million pesos (USD 5.4 million) for the second offence. This is a marked increase from the previous administrative penalties, such as the 1 million peso (approximately USD 22 430) maximum fine that the DTI may impose under the Price Act for cartelisation. It is generally accepted that high fines are a crucial element of deterrence. The amount of fines imposed for antitrust infringements, and for hard core cartel violations in particular, has significantly increased over the last decade. Many jurisdictions have statutory thresholds based on a percentage of the firm's turnover rather than pegging fines to an absolute amount. The

Competition Act instead provides for the Commission to increase the schedule of fines in the Act every five years to take inflation into account.

Like other administrative agencies, the Commission will not have the power to adjudicate or impose criminal liability, which may be determined only by the Regional Trial Court. Criminal violations of the proposed law would be punishable by imprisonment from two to seven years, and a fine ranging from 50 million pesos to 250 million pesos (approximately USD 1 million to USD 5.4 million). This is a substantial increase from the criminal fines under Article 186 of the Revised Penal Code (a 6 000 peso maximum fine) and the *Price Act* (a 2 million peso maximum fine). If the violation involves the trade or movement of prime commodities the *Competition Act* provides that the fine imposed by the Commission or the courts shall be tripled automatically (Chapter 7 Sec 41).

The prison term in the *Competition Act* is on par with the *Revised Penal Code* (from 6 to 10 years imprisonment for offences involving prime commodities) but lower than the possible 5 to 15 year prison term under the *Price Act*. The *Competition Act* provides that when the entity involved is a company, prison terms shall be imposed on its officers, directors, or employees in managerial positions, if they were knowingly and wilfully responsible for the violation.

The Act allows a right of follow-on private actions for damages from violations of the proposed law (Chapter 7 Sec 15). Arguably this is unlikely to become a major source of private enforcement or compensation due to its follow-on nature and the lack of awareness of the law generally, certainly at the outset.

Challenges to competition policy and competition law enforcement

Regulatory barriers to competition

Regulatory barriers and government restrictions account for a lack of competition in key sectors of the Philippine economy, compounding the previous absence of a comprehensive competition law and a suitably equipped competition authority to enforce it. And even though the *Competition Act* is to be commended for not exempting specific sectors or public bodies from the competition law, it does not address the fact that many competition problems stem from the anti-competitive impact of government actions on the market. This requires wider pro-competitive regulatory reform. Two examples are provided below of the effects of restrictions on key areas of the economy.

Domestic shipping industry

Competition in domestic shipping is limited, contributing to large-scale inefficiencies and higher prices of many goods, especially food. Logistics costs account for 24%-53% of wholesale price in the Philippines compared to less than 20% in other countries in the region. Shipping and ports are estimated to account for about 3%-30% of wholesale prices depending on the goods and routes.[28] It is more expensive to transport goods between two domestic points than between two domestic points via an international point. According to data compiled by a World Bank study, transporting a 40-foot container from Manila to Cagayan de Oro in Northern Mindanao costs some USD 1 860 but transporting from Manila to Cagayan de Oro via Kaohsiung would reduce the tariff by USD 716 to USD 1 144.[29]

Existing laws make it difficult for new shipping companies to enter the market. They also raise costs artificially by requiring that certain services (for example dry docking and repair) be done within the Philippines when cheaper options are available elsewhere. Until July 2015, Philippine laws also provided for so-called "cabotage" restrictions – these restrict foreign shipping companies from serving domestic routes even if they can provide better service. Removing competition constraints and enhancing the competitiveness of shipping companies would lead to greater efficiency, increased capacity, better quality ships, lower operating costs, and lower freight rates. This will have a positive impact on lowering food and input prices, improving producers' access to markets, and raising the incomes of farmers in less developed regions.

Reform of the shipping industry was recently made a priority. In his July 2013 State of the Nation Address, President Aquino identified cabotage liberalisation as a priority reform and asked Congress to amend the 50 year old cabotage provisions "in order to foster greater competition and to lower the cost of transportation for agricultural sector and other industries." Recent reforms include regulations adopted by the Maritime Industry Authority in 2014 that streamlined the procedural requirements for applications for a Certificate of Public Convenience (required to operate a commercial domestic shipping service in the Philippines) and limited the ability of incumbent firms to delay their issuance by eliminating the requirement that incumbents be informed of new market entry. Complementary reforms to liberalise cabotage and improve port efficiency are also required otherwise inter-island shipping costs are likely to remain high.

The amendment to the cabotage rules was enacted on 21 July 2015 at the same time as the new competition law. The *Foreign Ships Co-Loading Act* will permit foreign ships to serve local routes for import and export cargo. Specifically it will allow for the transport and co-loading of foreign cargos within Philippine waters by foreign vessels. Ships coming into the country will be able to transport container cargo to a destination port within the Philippines once they have cleared a port of entry. The co-loading provision allows for foreign vessels to transport container cargo of another foreign vessel bound for the same port. The reform is expected to improve competition in the sector and improve the country's attractiveness as an investment destination.

Price control

Price control exists for basic necessities and prime commodities under the *Price Act*, especially during periods of calamity, emergency or widespread price manipulation. The justification is to ensure the provision of commodities at a reasonable price at all times. Basic necessities and prime commodities are defined under the Act, and additional products may be included within the coverage of the law. The system is administered by the various government agencies with mandates under the Act, notably the DTI, the Department of Health, the Department of Agriculture, and the Department of Environment and Natural Resources. It is co-ordinated by the National Price Co-ordination Council, which includes the above government departments as well as representatives of manufacturers and retailers. The Council publishes suggested retail prices of commodities every three months, and suggested retail prices for seasonal items. The DTI and other government agencies monitor nationwide prices of the listed commodities, and if prices are found to be outside an allowable range then an order is issued to the relevant business requiring them to justify their costs. The list itself is determined by the DTI and is updated as necessary. A recent update of the list included bottled water, liquefied petroleum gas and noodles. There are regular warnings from the DTI and politicians on ensuring that products stay within their price caps.

Price controls are intended to protect consumers, particularly for food products or fuel. In December 2014, the DTI produced an amended list of suggested retail prices of basic commodities to reflect the 30% decline in the price of petroleum products. It declared that as a result, prices of basic commodities should come down by 3% at a minimum, but evidence suggests that even if price controls buffer the local economy from upward spikes in international commodity prices, these regulated prices do not mirror downward trends of commodity prices in international markets. This results in an effect opposite to the intended policy since consumers do not benefit from lower international prices. In addition, price controls increase business risks and discourage entry of new players that could generate competitive pressure.

In general, while price controls are not unusual in many jurisdictions, it is mostly accepted that price control should only be necessary in very particular circumstances, such as infrastructure markets where there are natural monopolies. And overall, price control should be unnecessary in markets free from structural constraints and which allow for effective market entry. The operation of competitive markets will drive prices down, allowing for new entrants to increase production when needed. Such a widespread and systematic price control system is therefore out of step with the economic reforms to introduce more competition in the economy. Consideration should be given to scaling back and eventually removing price controls, except in limited and time-bound circumstances to address market failures arising from exceptional circumstances.

An OFC report (June 2015) on the government's suggested retail price (SRP) mechanism highlighted a lack of rules and guidelines on the imposition of the SRP, which acts as a price ceiling and removes incentives to compete on price. The enforcement procedures for non-compliance along with the requirement for the retailer to have planned price increases approved, negates the recommendatory nature of the SRP. The report notes that the SRP did not prevent or detect the price hikes in the rice, garlic and onion sectors that the DOJ is prosecuting. It proposes amending the terminology to better reflect that it is a recommended rather than government imposed price. It also suggests that price controls be imposed only during calamities and disasters and only for basic and prime commodities.

Sectoral overlap

A number of sectoral laws give the sector regulators jurisdiction over competition matters as well as economic regulation in their respective industries. Even with the establishment of the OFC in 2011 the sector regulators continued to enforce the competition provisions in their respective sectors, where they exist. Consequently, the OFC made establishing relations with the sector regulators and asserting its role as the competition authority under EO 45 a priority. The OFC's first Policy Paper from 2013 dealt with the respective roles and functions of competition authorities and sector regulators and proposed a set of co-operation guidelines to determine OFC participation in competition investigations.[30] The OFC also entered into agreements with the Philippines Port Authority and the Energy Regulatory Commission where they are co-ordinating over the respective investigating a case of alleged collusion in the power industry.

The Act provides for the new Competition Commission to have primacy over competition matters. It will also have jurisdiction over any issue that involves both competition and non-competition matters, although it will have to consult the relevant sector regulator. It will have the authority to intervene and participate in the administrative and regulatory proceedings of other government agencies, which require a consideration of the Act, such as those before the Energy Regulatory Commission, the SEC and the National Telecommunications Commission (Chapter 2 Sec 2(n)). This is to ensure that the competition laws are interpreted and properly enforced. This may lead to conflicts with the sector regulators and it is expected that the Commission would build on the OFC's established relations with the regulators and enter into agreements with them to smooth the application of its intervention powers.

Ports

The Philippines Port Authority (PPA) is a government-owned corporation attached to the Department of Transportation and Communications, established in 1974 as the main developer, operator and regulator of ports. Most ports, especially the larger ones are under the control of the PPA. It supervises 119 self-owned ports and regulates over 500 ports, issues permits to construct and operate ports,and sets and collects port charges. It also approves increases in cargo handling rates and receives 10% of domestic cargo handling rates and 20% of foreign cargo handing rates. Port ownership and administration across the Philippines is highly centralised.[31]

The PPA's multiple roles as developer, operator and regulator lead to a conflict of interest and functions. It has little incentive to promote competition and has used its regulatory powers to protect its ports from competition delaying or not issuing permits to construct and operate private ports. This has disadvantaged private port operators. The PPA has also limited competition in cargo handling services by restricting cargo handlers in its ports to operating on specific piers and for specific shipping lines. This is compounded by a lack of transparent and competitive bidding processes for granting or extending cargo handling contracts. In addition, given that the PPA approves rate increases for charges and cargo handling in both PPA-owned and private ports, it is able to generate revenue increases for itself.

Competition in the ports sector has been weak and investments inadequate as a result of this regulatory and institutional framework. The sector would benefit from regulatory reforms to promote competition, notably through separating the PPA's regulatory responsibilities from its development and operations role.

Telecommunications

The telecommunications sector, which was dominated by a private monopoly, the Philippine Long Distance Company (PLDT), for more than half a century was liberalised in the late 1980s. Before that, waiting time for a telephone line could take up to ten tears and service quality was low. This liberalisation process was accelerated in the early 1990s. Cellular mobile services were liberalised in 1992 and in 1993 EO 59 mandated the interconnection of all carriers, while EO 109 opened up the basic telephone service to new entrants.

Regulation was separated from operations in the telecommunications sector under the 1995 *Public Telecommunication Policy Act*. It established the National Telecommunications Commission (NTC), as a state agency attached to the Department of Transportation and Communications, responsible for administering the provisions of the Act. This includes: ensuring telecommunications services are provided in underserved areas; granting Certificates of Public Convenience and Necessity (CPCN); establishing rates and tariffs in circumstances where competition is not feasible; resolving interconnection disputes; and allocating radio-frequency spectrum.

Companies wishing to provide public telecoms services (*i.e.* those involving the establishment of a fixed network) need to obtain a Congressional franchise, which requires the approval of both Houses of Congress. The maximum period for which a franchise may be granted is 50 years. Upon expiry, the franchisee must go back to Congress to get an extension. In practice, franchises have generally been granted for 25 years. Franchised public telecoms companies must then obtain a CPCN from the NTC in order to provide the relevant service. The CPCN specifies geographical area, type or classification of activities, regulations for providing the services and, in some cases, the rates chargeable.

As a result of the reforms, several players, including international investors, entered the telecoms market. By 2001, the industry had seven players and revenues grew 11-fold from about PHP 20 billion in 1993 to PHP 230 billion in 2008. The industry's contribution to value-added increased at a similar pace. The original monopoly that was the initial target of the liberalisation reforms, the PLDT, emerged as the biggest beneficiary of the reform, earning much higher revenues from a much bigger market.[32]

The telecoms sector remains highly concentrated, however, and has even reconsolidated. The wireless communications sector is dominated by PLDT, which extended its market share to over 65% following the controversial 2012 NCT approved merger with Sun Cellular – the ailing, smallest and most recent entrant in the cellular market. The third major competitor, Globe Telecom, has a market share of about 30%. The absence of a comprehensive competition law raises the potential for this merger to stifle competition.[33] The low penetration and the high cost of broadband internet stem partially from the lack of competition in the broadband sector, where PLDT controls 60% of the market. And since acquiring Digitel in 2011, PLDT has dominated the fixed-line sector, with as much as an 80% market share.[34]

The combination of a weak regulatory authority, a dominant carrier in fixed line and mobile services, significant market barriers such as foreign equity restrictions and the need for a Congressional franchise to provide telecom services, alongside unclear interconnection and access rules and pricing, has limited the impact of liberalisation efforts and restricted competition in the telecommunications sector.

Electricity

The power generation sector was opened up in 1987, allowing the private sector to invest and participate in augmenting the sector's generation base capacity. This was followed by the *Electric Power Industry Reform Act* (EPIRA) 2001 which prescribed the restructuring of the sector by separating the natural monopolies from the potentially competitive parts. Generation and supply would be competitive and open while transmission and distribution segments would be regulated.

As the principal regulatory body for the Philippine electric power industry, the Energy Regulatory Commission is tasked with ensuring that "no participant in the electricity industry or any other person may engage in any anticompetitive behaviour including, but not limited to, cross-subsidization, price or market manipulation, or other unfair trade practices detrimental to the encouragement and protection of the contestable markets" (Section 45 EPIRA). Section 8 of the Rules and Regulations to Implement the Act stipulates that the ERC shall promulgate competition rules prohibiting and specify appropriate remedies and penalties for restrictive practices. Consequently, the ERC issues "Competition Rules and Complaint Procedures" addressing anti-competitive agreements, misuse of market power, and mergers and acquisitions and consolidation.

One of the weaknesses in the competition-related provision of the EPIRA is that the Act provides for safeguards against anyone owning, operating or controlling more than 30% of the installed generating capacity of a grid, or 25% of the national installed generating capacity but allows for cross-ownership under these thresholds. This might lead to access problems and a conflict of interest as it allows a distribution company to enter into supply contracts with its generation subsidiaries.

In addition, the absence of clear rules and an appropriate regulatory framework in the early stage of deregulation led to discretionary decision-making, which resulted in high long-term costs and concerns over affordability. Alongside power shortages, these dominate the headlines. In 2014 Manila Electric Co (Meralco -the Philippine's largest utility) had its bid for a 75% short-term tariff suspended as the Supreme Court extended indefinitely a freeze on the firm's rate hike petition, citing the need to protect consumers. Access rules for transmission and distribution as well as pricing system changes that would allow consumers to share in efficiency gains have not yet been fully addressed.[35] As a result, the structure of the electricity sector is still a monopoly with National Power Corporation in generation, Transco in transmission, and Meralco in distribution.

In 2006, under its competition remit, the ERC launched an investigation into alleged price manipulation in the wholesale electricity market by the National Power Corporation and Power Sector Assets and Liabilities Management Corporation. The ERC did not find sufficient evidence to support a case but did note that the electricity market was not really competitive and was therefore prone to market abuse.[36] Since then, no other major investigation into any alleged restrictive practices in the energy sector was initiated until December 2013 when complaints were filed over alleged price fixing by power generation companies. It is currently under investigation by the ERC as well as the OFC.

Competition advocacy

Competition advocacy involves efforts directed both towards specific government entities and towards generating support for competitive markets and the building of what is often referred to as a "competition culture" in society. The first, intra-governmental advocacy, involves advising government on how public policies and institutions interact with markets and on how to minimise the impact of government interventions on competition. Competition culture advocacy on the other hand aims to increase the understanding within the wider society about competition and its benefits, including among consumers, civil society, academia and the business community. The objective is to increase understanding and support for competitive markets and compliance with competition law. Competition authorities generally engage in both forms of advocacy.

Intra-governmental advocacy

There was no explicit competition advocacy role for any of the government departments prior to the enactment of the *Competition Act.* However, one of the tasks assigned to the OFC by EO 45 was to prepare, publish and disseminate studies and reports on competition to inform and guide the industry and consumers. Although this did not expressly include intra-governmental advocacy, the OFC has directed much of its advocacy activities towards government stakeholders. It has used Policy Papers to set out its position for vesting competition powers in the competition authority rather than across sector regulators and the relative governance strengths of a competition authority in this regard.[37] It has also provided input and support to the legislative efforts to pass a competition law through co-ordination and consultation with the Senate and House of Representatives on the draft Bills.

The OFC has completed three sector studies, one on the reform of the Customs, Immigration and Quarantine officers' overtime charges, a second on liberalising the harbour pilots industry and a third on competition and regulation in the tug assistance service (Box 4.6). It has arguably not tackled the most significant regulatory barriers head on, but has tested the water with more modest proposals for reform in the first instance. This strategy is perhaps well conceived given the OFC's lack of enforcement powers and its reliance on the co-operation of other government agencies to progress its recommendations.

Box. 4.6. **OFC sector studies to date**

The case of Customs, Immigration and Quarantine (CIQ) Charges (July 2013)

In support of policy measures to improve the competitiveness of the transport industry and reports that business executives found customs procedures inefficient, the OFC launched a study to review the impact of overtime pay to Customs, Immigration and Quarantine (CIQ) officers and demonstrate the OFC's support for the economic reform introduced by the Aquino administration. The OFC reviewed the charges paid to CIQ agencies, which supervise a significant proportion of the transport industry, and noted that they significantly increase the cost of operating in the Philippines and highlighted that the practice of multiple billing by CIQ agencies is contrary to good governance. The OFC's study also outlined the main arguments put forward by supporters of reform, notably that the charges amounted to double taxation and the need for a modernised CIQ system. On the basis of this review the OFC endorsed its support for the reform which removed the CIQ overtime charges and introduced 24/7 operations, as a means of improving competitiveness in the transport industry. The study noted that the reform was estimated to have generated more than 400 million pesos (approximately USD 8 970 900) in annual savings to the air transport industry.

Box. 4.6. **OFC sector studies to date** (cont.)

Liberalising the Harbour Pilots Industry (October 2014)

This study was completed under the umbrella of the OFC-Philippine Ports Authority (PPA) Memorandum of Agreement signed in June 2013. The study identified the following competition restraints: (i) monopolisation of pilotage services due to exclusive privilege granted by an administrative order; (ii) conflict of interest in the determination of vacancies in pilotage as well as in the appointment of harbour pilots; (iii) lack of transparency in harbour pilots' transactions; and (iv) non-compliance of harbour pilots with the prescribed rates and services. The PPA and the OFC recommended liberalisation of the industry and the study provides a proposed Executive Order, for approval by the President to accomplish this. The policy proposes that harbour pilots would no longer be required to be members of a harbour pilots association and could charge competitive rates. The policy would also remove the limit on the number of harbour pilots per pilotage district. The aim of the proposal is not only to liberalise the pilotage industry and increase the competitiveness of Philippine ports but also to address the harbour pilots' conflict of interest in determining vacancies in pilotage and appointment of pilots. The policy would also require all harbour pilots to submit their financial records to the PPA. The proposed Executive Order is undergoing consultations with the PPA prior to finalising the draft for wider consideration by policy makers.

Addressing Competition and Regulatory Issues in the Tug Assistance Service (June 2015)

This study was also conducted under the OFC-Philippine Ports Authority (PPA) co-operation agreement. The study identified a number of competition and regulatory concerns. These included (i) a lack of competition in the provision of tug services; (ii) the use of exclusive contracts between tug assistance providers and port operators; (iii) potential cartel behaviour and opaqueness in tug rates; (iv) unfair advantage of harbour pilots as tug operators; and (v) non-registration of tug owners. The OFC made several recommendations for reforms. These would (i) remove unnecessarily high barriers to entry and exclusive contracts; (ii) make information on pricing/agreed-on rates more readily available; (iii) develop rules and regulations on unfair business practices; and (iv) sanctions for non-compliance by tug operators.

The OFC has also taken advantage of other opportunities to make recommendations on anti-competitive regulations. It took part in consultations on amendments to the National Internal Revenue Code to grant income tax exemptions to international air and shipping carriers that are expected to result in international carriers opening or adding flights to the country, and reducing fares.

Building a competition culture

The Philippines lacks a strong consumer base to support competition. Continued advocacy efforts will be necessary to increase stakeholder support. Consideration should be given to creating a more interactive and user-friendly website to complement these efforts. This might include simple explanations of the purpose of competition law and policy and examples of how it benefits consumers and business.

The *Competition Act* includes a specific advocacy mandate for the new Competition Commission. Chapter 2 Sec 8(m) provides that the Commission will have a general role of issuing advisory opinions and guidelines to support the effective enforcement of (and presumably compliance with) the Act. It can submit reports and proposals to Congress to propose legislation for the regulation of commerce, trade and industry. A function akin to a market study is envisaged with the Commission mandated to monitor and analyse the practice of competition in markets that affect the Philippine economy. The Commission will also have a general role of promoting a competition culture by publishing reports and studies on anti-competitive conduct and agreements to raise awareness and guide business and consumers.

The Act also provides for a "National Competition Policy" which is to be developed by the National Economic and Development Agency, in consultation with the Competition Commission and sector regulators. It is not clear what this policy's objectives are. Will it develop proposals for a programme of micro-economic reform like the Australian model from the 1990s, or is it more generally about raising awareness of competition and across government? The *Competition Act* also provides that the government is to conduct an advocacy programme to inform the general public about the Act during the two year transition period.

International aspects

Regional integration and trade agreements

The 2015 target for implementing the ASEAN Economic Community was a clear driver for the Philippines to implement the *Competition Act* to meet its ASEAN commitments. But beyond this specific commitment, the free trade agreement itself gives rise to pressure for effective competition legislation. The free trade area generates a focus on competition in non-traded goods and services, as exporters and importers become concerned at the impact on their competeviness of any lack of competition in relation to the businesses that supply them. In addition, if imports face domestic anti-competitive obstacles to reaching consumers there is likely to be pressure from exporters in other countries and from import agencies and businesses in the importing country for the removal of any domestic "behind the border" obstacles to the realisation of the benefits of free trade.

Economic integration therefore forces the Philippines to open up its markets further. In addition to existing free-trade agreements with major regional trading partners such as China, Korea, Australia and India, the Philippines is also conducting free trade negotiations with the European Union and the United States. Membership of the Regional Comprehensive Economic Partnership with ASEAN dialogue partners[38] and participation in the Trans-Pacific Partnership dialogue would expand opportunities for the Philippines.[39] Participation in these agreements and negotiations will require further economic reforms to improve the investment climate and promote competition in the Philippines.

International engagement

The OFC is currently recognised across the international community as the central agency responsible for the existing competition laws and policy within the Philippines. It has been proactive in the international arena and its dynamic approach to regional and international organisations as well as bilateral relations with other competition authorities has fostered significant international co-operation and assistance. The new Commission will take on the role of official representative of the Philippines government in international competition matters. It will benefit from the in-roads that the OFC has made regionally and internationally, which have galvanised support for capacity building and assistance from international donors.

Within ASEAN, the OFC has assumed an active role in the ASEAN Experts Group on Competition, a body established in 2007 under the ASEAN Economic Community as a forum for discussion and co-ordination of competition policies. The OFC chaired the Group in 2013-14 and introduced a number of ambitious projects designed to accelerate the pre-integration process. These include: a proposal for a regional co-operation framework to lay the groundwork for co-operation in enforcement, information sharing and technical assistance; developing and implementing sector studies in the region; categorising the Group's documents to assist with knowledge management system and a proposal to measure the effectiveness of ASEAN Member States individually and collectively through a series of major indicators. The OFC's willingness to assume a high profile role provides it with an excellent opportunity to highlight the expectations on ASEAN Member States to implement a comprehensive competition law, and how the Philippines fares against the ASEAN Regional Guidelines on Competition Policy. It is also an opportunity to assess the effectiveness of neighbours' experiences with implementing their respective competition laws and relevant lessons that the Philippines can derive from this.[40]

The OFC has been an active participant in the activities of international organisations. It completed a peer review by UNCTAD in 2014 and is a regular participant in International Competition Network meetings, the annual OECD Global Forum, and the OECD-Korea Policy Centre Competition Programme. The OFC also hosts a number of regional meetings, including the East Asia Conference on Competition Policy and the East Asia Top Officials Meeting. An agreement with the World Bank in 2013 provides for a four-year project to identify and address competition barriers in domestic trade and logistics sectors. This includes a study on product market regulation using the OECD's PMR indicators methodology to assess the economy-wide and industry- specific regulatory structures and policies that restrict competition in upstream markets such as electricity, energy, telecommunications and transport.

The OFC and other stakeholders also benefit from targeted capacity building activities. Under the EU's Trade Related Technical Assistance 3 project, which aims to support the Philippine's integration into the international and regional trading and investment system, the OFC is the implementing agency for the component on competition policy development. This supports capacity building as well as sector studies in priority sectors identified by the OFC, notably energy, telecoms and the transport sector. The Australian Competition and Consumer Commission is providing assistance, for example in the preparation of an investigation manual for the OFC. Likewise the US Federal Trade Commission and the Department of Justice have held capacity building workshops. Several donor agencies and other groups have long-standing technical assistance programmes that support the OFC and other stakeholders in areas of competition policy and regulatory reform.[41] A memorandum of understanding signed with the Japan Fair Trade Commission in 2013 and with the Australian Competition and Consumer Commission in 2014 provide for improved co-operation and capacity building. The OFC expected to sign three more MOUs by end of 2015.

Policy recommendations

In the short- to medium-term the priority must be to operationalise the *Competition Act* and the new Competition Commission.

Main implementation challenges:

- Certain provisions of the *Competition Act* are likely to impede effective enforcement of the underlying objectives of the Act. It contains a number of provisions that are not commonly found in the laws or enforcement practices of other jurisdictions. These should be clarified and mitigated as far as possible through the implementing rules and regulations to avoid legal uncertainty and the risk of politicising the implementation of the law.

- The 180 day timeframe to complete all of the implementing rules and regulations envisaged in the law is very tight given (a) the number of details the Act leaves to the implementing rules, and (b) the need to clarify how some of the provisions will be interpreted and applied in practice. The development of these secondary regulations could be staggered to give more time to the process. This would also allow for more consultation of interested parties and for their feedback to be given due consideration, which will enhance buy-in.

- Raising awareness of the Act and changing attitudes to established business practices in the Philippines will be a considerable challenge.

Key implementation factors for success:

- ***Clear and robust implementing rules and regulations.*** Clear implementing rules and regulations are needed to articulate the new Competition Commission's interpretation of the law and avoid the potential negative effects of provisions that are at odds with established best practice. These should address the following provisions:

  – Exemptions and exclusions:

    – Limit the broad exemption powers which allow the Competition Commission to determine whether enforcement is warranted on general public interest grounds (Chapter 5 Sec 26) and which enable it to exempt individual entities from the Act (Chapter 5 Sec 28). Develop transparent principles to assess requests for exemptions from the competition law to limit their number, as well criteria for when they will be revoked. Establish clear criteria for exemptions on public interest grounds.

- Abuse of dominance:
  - Clarify that market shares are not the only element on which dominance will be assessed (Chapter 5 Sec 27)
  - Limit the Commission's power to set market share thresholds for dominance in particular sectors as this will create legal uncertainty (Chapter 5 Sec 27)
  - Limit the "in good faith" exemption for predatory pricing, which has the potential to be used to exonerate anti-competitive below cost selling.
- *Mergers:* Clarify that administrative fines for a prohibited merger would, in practice, not be applied (Chapter 6 Sec 29(a)). Instead penalties for failure to comply with a notification requirement should be applied.
- Sanctions and remedies:
  - Limit the Commission's monitoring function for non-adjudicatory administrative remedies (Chapter 7 Sec 37(d)), as this generally only applies in merger control, and it is likely to be resource intensive.
  - Limit the use of structural remedies from the Commission's non-merger/market investigation functions given their intrusiveness and potential chilling effect on competition.

The development of Implementing Rules and Regulations should also clarify legal criteria and tackle the following:

- ***Clarify the status of the OFC's enforcement and merger guidelines.*** The OFC Guidelines may inform the development of the Implementing Rules and Regulations as well as internal working documents for the new Commission. However there are inconsistencies with the new Law. The Act should be the starting point to define specific prohibitions and avoid inconsistencies between their respective descriptions of types of anti-competitive agreements, abuses and merger review procedures in the transition period. The status of the OFC's Guidelines and whether and how they will be used by the new Commission should be clarified to provide certainty and continuity to business during the transition period.
- Publish guidelines on the manner in which the Commission intends to enforce the *Competition Act* after the Commission has acquired some

enforcement experience. Publishing external guidance for a competition authority with little or no enforcement experience is premature. It can be difficult to amend previously published guidance, and to do so would create legal uncertainty. Instead, the new Competition Commission should adopt working internal guidelines to ensure a principled approach to enforcement and consistency in its approach. At the appropriate time, external guidelines may be published to reflect enforcement experience, and practice in taking enforcement decisions on cases. This would also take account of the direction and guidance from court decisions.

- ***Adopt policies and procedures to embed transparency, integrity and accountability into the new Competition Commission.*** Accountability is necessary to maintain independence in the longer term. Stakeholders, including politicians, the media, the public and the business community should know who is responsible for a decision, and the reasoning behind it. Interested parties should be able to provide relevant input to decisions through consultation processes. Furthermore, they should be able to obtain redress easily and quickly if the competition authority has acted arbitrarily or incompetently. Communication and transparency are key for accountability. It is therefore common practice for competition authorities to make their final decisions readily available to stakeholders, usually through their websites and the press. The new Commission should publish annual reports and financial accounts in line with national reporting requirements, as well as reasoned case decisions. It should systematically make information on its laws and regulations, activities and case decisions readily available through its website. It should also implement public consultations to seek views on proposed activities/priorities and the development of normative standards and guidelines. It would also be good practice to seek feedback from stakeholders about the quality of the Commission's work through annual surveys.

- ***Develop prioritisation principles for enforcement and advocacy activities***. Most competition agencies have a set of different criteria to help them set and guide their enforcement priorities. The process of prioritisation enables a competition agency to concentrate its limited resources in specific areas identified as being of greatest importance. Prioritisation can take into account a wide range of immediate or strategic criteria but should mainly be determined on the basis of the expected direct and indirect effects of any action. The process is intended to make it possible to concentrate resources on high-impact sectors or significant cases and projects, usually this means focusing on the most potentially harmful conducts, precedent-setting cases that clarify the law, significant market studies, and advocacy projects on critical concerns. The adoption of prioritisation principles would signal to business, consumers and commenters what the Commission's key concerns are within the existing legal framework.

- Implement a mechanism to facilitate knowledge transfer from the OFC and build institutional capacity at the new Competition Commission. The experience, knowledge and processes developed by the OFC should be captured and transferred to the new Commission in so far as they relate to the functions that will transfer to the Commission. Where feasible, OFC staff should be able to transfer over to the new Commission to provide continuity and assist in building the Commission's institutional capacity. The new Commission should develop a training needs assessment and establish on-going capacity building programmes with regional and international providers.

- ***Provide additional funding to cover the resource implications of the new law for the DOJ's prosecution regime.*** Criminal offences under the Act will be prosecuted by the DOJ, with the OFC investigating and collecting evidence, the National Bureau of Investigation also assisting and collecting evidence and the National Prosecution Service conducting a preliminary investigation if a decision is taken to proceed to court. This will involve additional demands on all agencies, which must be adequately resourced.

- Develop an advocacy strategy targeted at government officials to educate them about competition and introduce competition assessment. The Commission should build on the OFC's advocacy work and inform public policymakers about how the choices that they make, at the government level, can have negative effects on competition. The Commission should also adopt a competition assessment methodology, such as the OECD's Competition Assessment Toolkit, to identify anti-competitive policies and regulations and propose less restrictive alternatives. Competition assessment provides competition authorities with an invaluable tool in structuring their intra-governmental advocacy efforts. This would complement the use of market studies to identify competition problems in markets and provide an evidence-base to advocate for pro-competitive reforms. The Commission's intra-governmental advocacy work should be linked to a strong communication plan and build on the OFC's efforts to develop a competition culture in the Philippines with business, the judiciary, consumers and academia.

- ***Measure and communicate the harmful effects of anti-competitive practices to encourage support for competition policy.*** The Commission and other stakeholders should identify topics that resonate with the public. Policy-makers understand the importance of competition enforcement better when the negative effects of anti-competitive practices on citizens and business are measured. Communicating the harmful costs of anti-competitive practices and articulating the benefits of more competition among firms in specific cases also helps build credibility and advocate for overall competition reforms in other markets.

Factors necessary for the success of the new competition regime

- ***Ensure the independence of the new Competition Commission***. Most competition authorities are independent from political interference and this is considered critical to effectively implement their mandates. An independent authority with a specific mandate and predictable decision-making that remains constant through a change of government will be better able to limit the extent that business groups can lobby government agencies for favourable treatment; and it provides business with greater regulatory certainty. Budgetary autonomy can support independence, for example a multi-year budget cycle, if feasible, could enhance the independence of the Competition Commission. The new Commission should promote its independence by adopting a statement setting out its commitment to transparent principles and implementing operational guidelines to this effect.

- ***Identify a government champion to support competition law and policy.*** A completely autonomous competition authority can become isolated from policy decisions and initiatives. In some instances this may weaken advocacy efforts due to the difficulty in conveying messages to policy makers during the elaboration of new policy initiatives. Too great a disconnect from the government system can also disadvantage the authority in terms of timely and comprehensive information on reform proposals. The new competition law will need strong political support and backing. Moreover, it will require a strong commitment on the part of the legislature and the executive to change the business climate as part of a package of economic reforms. It must not be seen in isolation as a law entrusted to, and the sole responsibility of a competition authority. It must be adopted as a whole-of-government policy if it is to be effective. While the new Commission will report to a Congressional Oversight Committee, consideration should be given to a more formal "line Ministry" type responsibility under a significant government body in order to "champion" the Commission's role to other government departments. Otherwise the Commission risks having a relatively low level of influence on the policy-making process, despite having a broad advocacy mandate.

- ***Address major regulatory barriers to competition.*** Priority should be given to enhancing competition in key sectors of the economy where there is potential to reduce poverty and spur growth. Notably:

- ***Promote the development of pro-competitive regulatory policies in regulated sectors.*** Use the Commission's primacy over competition laws to foster competition in the regulated sectors, such as assuring non-discriminatory access to essential networks and tackling behavioural barriers to entry.

    – Guarantee the interconnection between the incumbent and new entrants for effective competition in the telecommunications sector. Clear rules are needed on interconnection and terms of access along with effective implementation of competition law and regulation.

    – Ensure adequate and affordable power supply in the electricity sector. This requires more focused implementation of competition law in the power retail market and lowering the threshold for open access so that the market becomes more contestable.

  – ***Reduce and eventually remove price regulation for basic commodities.*** This systematic price control system is contrary to the principle of introducing more competition in the economy. Price control should be unnecessary where no structural barriers exist and the market is contestable. The operation of competitive markets will drive prices down, allowing for new entrants to increase production when needed. The price control system for basic commodities should be scaled back and eventually repealed, except to address market failures in limited and clearly defined circumstances.

  – ***Review the mandate of the Philippines Port Authority (PPA) and divest its ports operations function.*** Competition in the ports sector is weak and investments are inadequate. Divest the PPA of its conflicting roles of regulator, developer and operator of ports, to avoid it using its regulatory powers to protect its own ports from competition. In addition, remove the link between PPA revenue and cargo handling charges to reduce a conflict of interest. This will reduce the price of goods and improve access to markets.

Notes

1. The information in this report is based on information provided and publically available information as of 11 September 2015.
2. NEDA (2014)
3. Joint Foreign Chambers of the Philippines Statement on Competition Legislation, 2011.
4. Philippines Chamber of Commerce 2014, *Manifesto of Support for the Adoption of a Competition Policy and Competition Law in the Philippines.*
5. Remo, A.R. “Exporter Cheer passage of Competition Law”, *Philippine Daily Inquirer*, 22 December 2014.
6. Makati Business Club 2014.
7. Chapter 11, Section 50(1) Executive Order No. 292 Series 1987 Instituting the Administrative Code 1987.
8. OECD (2015).
9. ASEAN (2010).
10. Tatad vs Secretary of Department of Energy, GR No. 127867 5 November 1997.
11. Prime commodities are defined as goods other than basic necessities that are essential to consumers in times of crisis or calamity.
12. See, for example, Mumar (2010).
13. Tatad vs Secretary of Department of Energy, GR No. 127867 5 November 1997.
14. Romero P.S. “House leaders say anti-trust bill to be passed next week”, *The Philippine Star*, 7 March 2015.
15. Energy Regulatory Commission: Rule 9, Sec 4 Competition Rules and Complaints Procedures.
16. Executive order 913.
17. National Bureau of Investigation (NIB): responsible for criminal investigation; completes criminal investigations it considers display “probable cause to warrant prosecution” and sends them to the National Prosecution Service which in turn independently determines whether there is probable cause to lodge criminal charges; if it establishes a *prima facie* case the matter is filed in court.

18. Represents a number of regulators before the appellate and supreme courts.

19. Provides legal advice and representation to some regulators and government-owned corporations.

20. American Bar Association-Rule of Law Initiative (2012).

21. These figures represent the core manpower complement that handles core functions and do not include support staff for administrative, finance, recruitment, liaison, utility, security, procurement and other related tasks or operational requirements of the OFC. These are undertaken by another 20 staff.

22. UNCTAD (2014), p.26.

23. OFC-DOJ (2013).

24. OFC-DOJ (2014).

25. Sy (2015), p.8.

26. DOJ Circular No. 11 *Guidelines Governing the Implementation of Executive Order No. 45, series of 2011, Designating the Department of Justice as the Competition Authority*, 1 Match 2013

27. OFC Case-Handling Procedure, 22 May 2015

28. World Bank (2015), p. 63.

29. World Bank (2014), pp 115-116.

30. OFC-DOJ (2013).

31. Llanto et al. (2005).

32. World Bank (2013), pp 128-129.

33. Aldaba (2011).

34. BTI 2014, *Philippines Country Report.*

35. Aldaba (2008,) p 44.

36. ERC case No. 2007-421 MC.

37 OFC-DOJ (2013) and OFC-DOJ (2014).

38. Australia, China, India, Japan, New Zealand and Korea.

39. Approximately half of the current Philippines' exports and one-third of its exports are accounted for by the current TPP countries and about a quarter of its FDI comes from these countries.

40. In line with these initiatives, the OFC accomplished several activities and outputs: (1) paper on existing best practices on regional cooperation and a related three-day workshop attended by ASEAN competition authorities on 3-5 November 2015 in partnership with the ASEAN-Australia-New Zealand Free Trade Agreement Competition Committee, Australian Competition and Consumer Commission (ACCC) and ASEAN Secretariat, as preliminary steps for a more formal regional cooperation arrangement; and (2) AEGC Kick-off Workshop on Sector Studies on 11-12 March 2014 with support from the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ). The OFC continues to render assistance in the ongoing development of a web portal as part of the AEGC's knowledge management efforts and the identification of indicators to measure the effectiveness of competition agencies.

41. The Japan International Cooperation Agency (JICA), Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), United States Agency for International Development (USAID), Asia-Pacific Economic Cooperation (APEC) and Consumer Unity and Trust Society (CUTS) International.

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Chapter 5

Infrastructure investment in the Philippines

The Philippine economy, one of the fastest growing in Southeast Asia, is placing increasing demands on existing infrastructure networks. Although levels of public spending on infrastructure have historically been low, this trend is being reversed, together with growing openness to private participation and greater competition in infrastructure markets. A programme for public-private partnerships (PPPs) was launched in 2010 and the authorities aim to accelerate its roll-out, notably by establishing a PPP Centre and planned amendments to the Build-Operate-Transfer (BOT) Law. Nonetheless, persisting gaps remain in terms of policy implementation, infrastructure regulation and effective investment attraction in key sectors. This chapter examines the current context of infrastructure development in the Philippines. It reviews the recent reforms to boost infrastructure investment, including to enhance private participation in infrastructure, and the remaining obstacles to improving the legal and institutional framework for private investment in infrastructure.

Summary

The Philippines economy, one of the fastest growing in Southeast Asia, is placing increasing demands on existing infrastructure networks. Although levels of public spending on infrastructure relative to GDP have historically been low, this trend is being rapidly reversed, together with growing openness to private participation and greater competition in infrastructure markets. The transport sub-sector is being modernised, for example, to enhance regulatory certainty, facilitate project bidding and streamline inter-agency co-operation. A programme for public-private partnerships (PPPs) was launched in 2010 and the authorities aim to accelerate its roll-out, notably by establishing a PPP Centre and planned amendments to the Build-Operate-Transfer (BOT) Law. There is an ambitious and dynamic evolution towards greater private investment in infrastructure networks in the Philippines, but persisting gaps remain in terms of policy implementation, infrastructure regulation and effective investment attraction in key sectors. Policy reforms are necessary across several fronts in order to improve the quality, coverage and affordability of infrastructure networks in the Philippines, especially if these are effectively to support accelerated and inclusive growth.

Many of the necessary reforms relate to infrastructure market regulation and competitiveness. As recognised by the Philippine Development Plan 2011-16, and as Chapter 4 investigates in more detail, current regulatory arrangements of infrastructure sectors are rather dispersed. Sector regulators frequently lack scope of action over the entire infrastructure sub-sector, as well as independence from line ministries (having in most cases the status of "attached agencies"). There is frequent overlap and lack of role clarity among the different agencies and departments active in infrastructure sub-sectors. Partly as a result, reforms to open these sectors to greater private participation have met with insufficient uptake. Rates of return on investment in these sectors remain too uncertain (or simply too low, as in the ports sector) for many investors. There is also room for enhancing competitiveness and transparency in infrastructure procurement processes, as well as in regulation of infrastructure operators and prices. Nevertheless, current improvements in the competition regime (see Chapter 4) may set the stage for stronger collaboration between sector regulators and the Philippines competition agency in infrastructure markets.

Alongside, some options for reform are more specific to the regime for PPPs which has so far experienced delays in putting contracts out to bid and has secured relatively little private sector interest. In part, this can be explained by the market competitiveness elements addressed above, but also by the poor track record with PPPs in the past. Several PPPs have suffered

from poor risk management, ineffective dispute resolution between public and private parties, fiscally unsustainable government guarantees provided to private partners, and excessive use of unsolicited bids. Many improvements are accordingly being brought to the PPP regime, which could make a real difference in attracting investment if they are accompanied by a strong implementing framework. The many disparate laws and regulations relevant to private participation in infrastructure would also need to be further rationalised, in view of greater legibility and more effective implementation. Despite considerable streamlining (especially since 2003), the legislative landscape currently remains a source of confusion for investors as well as for central and local contracting authorities.

On the institutional front, ongoing revisions to the PPP act (the “BOT-IRR”) could be an opportunity to better delineate the respective responsibilities of the PPP Centre and the PPP Governing Board; and to establish effective frameworks for end-user engagement and consultation throughout the infrastructure project life-cycle. The phrasing of several considered amendments to the BOT-IRR (which are aimed to accelerate the approval and deployment of infrastructure projects, see Box 5.8) could also be made more precise so as to safeguard the interests of local communities and end-users. Government capacity to manage PPPs would also need to be strengthened, especially at the local level. In road transport in particular, given the heavy focus of public expenditures in this sector in recent years, recipient public authorities would need better capacity to effectively spend their budgetary allocations, including via well-designed, procured and managed PPPs (ADB, 2012).

Quality and coverage of infrastructure sub-sectors: An overview

The Philippine government has long underspent on physical infrastructure networks; public infrastructure spending ranged between 1.4% and 2.1% of GDP between 2008 and 2012, proportionally below the levels of most other ASEAN countries (Llanto and Navarro, 2014). As a result, infrastructure gaps remain widespread, constraining businesses and residential end-users alike. Infrastructure deficits have been consistently cited by investors as one of the most problematic factors for doing business. The Asian Development Bank estimates that the Philippines needs USD 20 billion annually in infrastructure investment to sustain economic growth, attract direct investment and alleviate poverty (ADB, 2013).

The most critical gaps appear to lie in road and rail connectivity, logistics, and energy. The road network in the Philippines expanded, and the proportion of paved roads increased, during the 1990s but then began to deteriorate in the following decade. As a result of recent improvements, however, there are now 28 919 kilometres of road. In the power sector (Box 5.1), growing demand has outpaced generation capacity, power outages are frequent, and power supply is geographically concentrated, with insufficient interconnection links between islands (Corong et al., 2013).

Box 5.1. **Capacity challenges in the Philippine power sector**

Despite low consumption levels relative to other ASEAN countries, the Philippines is a net energy importer. Oil makes up about 40% of energy consumption, followed by coal and biomass (both at about 20%), and natural gas and renewable sources for the rest. Total domestic installed capacity (at 17 609 MW as of October 2014) depends mostly on hydrocarbon (20%), coal (32%) and oil (19%), hydropower (16%) and geothermal (11%).

Power supply in the Philippines is geographically concentrated; for instance in Mindanao most capacity is located in the North areas despite most demand coming from the South (Corong et al., 2013). Energy demand has been rising across the country, in line with a growing population but also increasing use of energy in response to unpredictable weather occurrences (see Figure 5.4). Peak demand is forecasted to grow at an annual average rate of 4.3% over 2012-2030. According to the DOE, installed capacity in the Philippines was about 17 025 MW in 2012. While this is expected to increase by about 60% (to reach 25 800MW) by 2030, it would remain under the projected demand for that year (29 330MW). Moreover meeting this ambitious generation target in large part depends on attracting sufficient private sector interest: the Philippines Energy Plan calls for private investment to cater to 11 400 MW of new capacity to meet domestic power requirements by 2030.

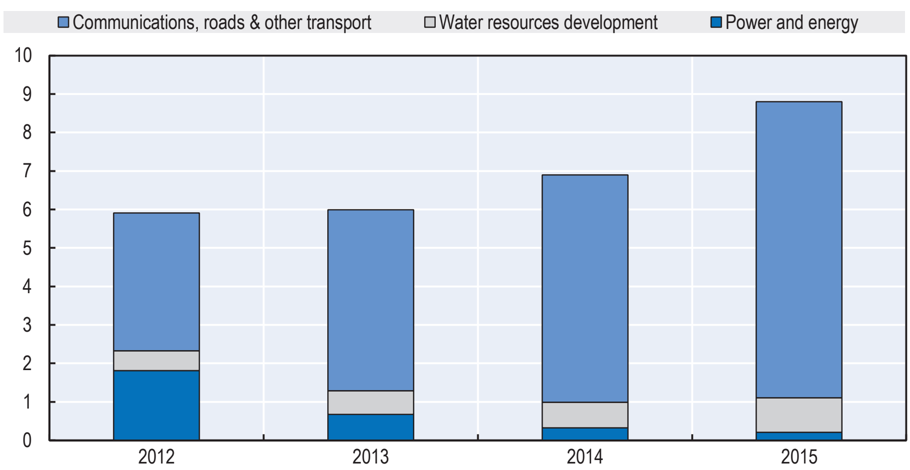
Sources: Corong et al., 2013; US EIA 2014; Philippines National Transmission Corporation, 2015; Philippines DOE (2014), 25th Status Report on EPIRA Implementation.

As poor rural areas suffer even more from inadequate transport networks and power shortages, infrastructure development can play an important role in mitigating urban-rural disparities in the Philippines (OECD, 2012). The vulnerability of the Philippines to natural disasters, including flooding, also makes it particularly important to develop resistant infrastructure networks, especially as regards transport and water and sanitation. Flood control took up 16% of planned expenditures of the Department of Public Works and Highways in 2015, the second largest item after highways spending at 64% (Singson, 2014).

In telecommunications, investors point to slow and expensive internet connections: the Filipino average of 3.6 Mbps per day is far below the ASEAN average (12.4 Mbps) as well as the world average (17.5 Mbps) while also more costly (Magdirila, 2014). Insufficient progress has been made on this front despite rapid expansion of Business Process Outsourcing (BPO) activities in recent years. These gaps will need to be tackled rapidly if the BPO-IT industry is to grow to its full potential: it currently employs over one million Filipinos, with 1.6 million new job creations expected for 2016. The World Bank estimates that with adequate conditions in place, the sector could generate up to USD 55 billion – about 11% of GDP – by 2020 (Romualdez, 2015).

To address these infrastructure gaps, the Philippine Development Plan 2011-16 sets out strategies and major programmes to address infrastructure backlogs and aims to increase public infrastructure spending to at least 5% of GDP by 2016. In line with these objectives, public spending on infrastructure rose to 2.7% of GDP in 2013 and 3.2% in 2014, with 5% (about USD 12.8 billion) budgeted for 2015 (Singson, 2014). This spending has been increasingly focused on roads and transport, with a decline in the amount allocated to water and energy (Figure 5.1 and Box 5.2).

Figure 5.1. **Spending allocations in 2015 Budget** (USD billion)



Source: Philippines DBM (2015), *Budget Briefer*. September 2014. Available at: www.congress.gov.ph/cpbo/images/PDF%20Attachments/Budget%20Briefer/2015%20DIMENSIONS.pdf

StatLink http://dx.doi.org/10.1787/888933345147

Box 5.2. **Public investment plans to support Philippine ground transport**

The 2004-10 Medium-Term Philippine Development Plan announced that the government would prioritise transport infrastructure projects so as to boost trade and investment. This increased importance granted to transport has since been strongly reflected in public spending allocations.

The Department of Public Works and Highways (DPWH) received the second largest allocation in the 2015 Budget (PHP 303.2 billion or USD 6.9 billion), 38% higher than 2014, mostly to expand national roads, while the budget for the Department of Transportation and Communication (DOTC) rose by 22% to PHP 59.5 billion (USD 1.4 billion) to fund infrastructure projects in the rail, ports and airports sectors. Combined, communications and transport thus receive about 87% of budgeted 2015 infrastructure spending, a steady increase since 2012 where it constituted 60% (Figure 5.1). The emphasis on roads is also very visible in the Public Investment Programme for 2011-16, where USD 35 billion (58% of the total infrastructure component) is targeted for the sector. There is also ongoing momentum to increase infrastructure multi-modality and to ensure that the transport network links adequately to key economic sectors

While these increases are positive, they need to be well balanced with allocations to other infrastructure sectors where capacity gaps also remain large. Moreover and as highlighted by the ADB in a 2012 assessment of the transport sector, budgetary allocations should take into account the absorptive capacity of recipient authorities at central and local levels. Otherwise the proportion of unspent allocations can be quite high. Due to deficiencies in financial management and procurement procedures, in 2007 the DPWH for instance disbursed only 66% of its available budget, despite clear spending needs. Measures towards timely roll-out of procurement procedures, as well as of PPP project preparation, bidding and negotiation in the transport sector, will be essential if budget allocations are to reach their intended objectives. DPWH and DOTC strategic plans will also need to be better linked to regional development plans, in view of more seamless inter-island connectivity.

Source: ADB, 2012; Singson, 2014 (Philippines Department of Public Works and Highways); & Philippines DBM, 2015.

A government drive for greater private participation in infrastructure

The increased budgetary allocations of recent years are expected to support and complement greater private participation in infrastructure. Attracting private infrastructure investment is made easier when infrastructure policy priorities and medium to long-term goals are clearly stated and fully embedded in national economic development strategies.

This coherence can further assure investors of the long-term political commitment to private participation in infrastructure development, while securing greater policy co-ordination and making clear the government's sectoral priorities. Establishing a credible pipeline of infrastructure projects aligned with development objectives is also likely to attract more investors and facilitate market competition.

Different development strategies of the Philippines place particular emphasis on re-mobilising private investors in infrastructure:

- The Philippines Investment Priorities Plan for 2014-16 lists sectors/activities that may qualify for registration with most investment promotion agencies; these are priority sectors towards which fiscal incentives will be targeted, and where private investment is actively encouraged. It includes energy exploration and development, as well as power generation plants; and airports and seaports (including RO-RO ports) for cargo and passengers.

- Chapter 5 of the Philippine Development Plan 2011-16, focused on infrastructure, sets out encouragement of PPPs as a key objective. Likewise EO 8 (2010) describes the PPP programme as a "cornerstone strategy to accelerate the infrastructure development".

- The public sector should contribute over 67% of infrastructure spending for the Public Investment Programme 2011-16, the private sector 18.5%, followed by government-owned and controlled corporations (8.8%) and ODA grants (2.5%) (Llanto & Navarro, 2014).

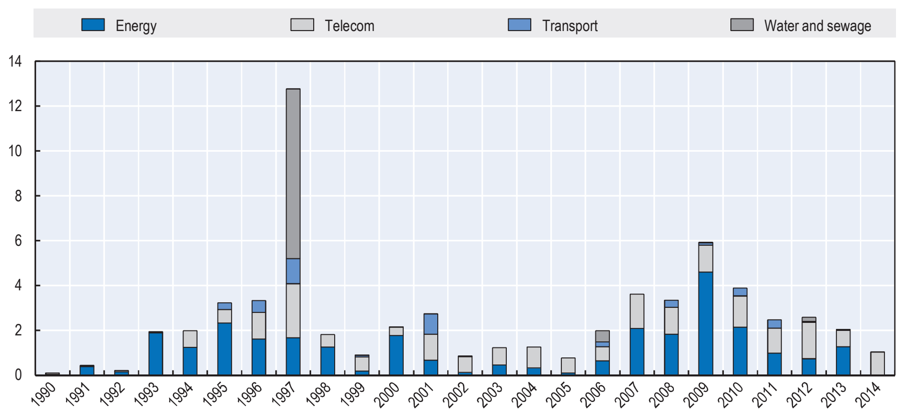
- The Comprehensive and Integrated Infrastructure Programme calls for the private sector to bring PHP 401 billion (USD 9 billion) in financing, of which over half in the transport sector. Between 2013 and May 2015, private sector investments accounted for roughly 26% of total investments (USD 42 billion) in this Programme.

- A scheme for PPPs was launched in 2010 and has since been backed by a growing institutional structure, including a PPP Centre attached to the National Economic and Development Authority; and a PPP Governance Committee. These agencies have designed an increasingly robust and populated PPP project pipeline (*see below*).

Private participation in infrastructure is not new to the Philippines, which was the first country in Asia to pass a law enabling concessions or PPPs (the 1990 *Build-Operate-Transfer Law*). Private investment in water and sanitation peaked in 1997 (Figure 5.2) due to the privatisation of the state-owned and operated Metropolitan Waterworks and Sewerage Systems

(IFC, 2015).[1] This remains the largest water privatisation in the world (KPMG, 2015). Private investment has also been particularly encouraged in the power sector through IPP contracts between the state-owned National Power Corporation (NPC) and private power generators. The Energy Reform Agenda for 2010-16 further focuses on the use of PPPs to meet domestic needs across all phases of energy development and utilisation. Looking at total projects with private sector participation over 1990-2014, Figure 5.3 shows that different contractual modalities have been favoured in different sectors, with greenfield investment dominating energy and telecom, and concessions more common in transport and water. Cumulatively, private investment has been highest in energy and lowest in transport.

Figure 5.2. **Private investment in projects by primary sector, 1990-2014**
(USD million)



Source: World Bank Private Participation in Infrastructure Database, 2014.

StatLink http://dx.doi.org/10.1787/888933345155

Limited foreign investment in infrastructure sectors

Owing to strict rules on foreign participation in several infrastructure markets, private investment remains largely domestic. As mentioned in earlier chapters, the 1987 Constitution states that only firms owned at least 60% by Philippine nationals or corporations may be approved to operate a public utility.[2] A government stipulation that bidders must have successful experience in running similar projects has retained space for foreign companies in some sectors, as has the recent clarification by the Supreme Court that power generation is not a public utility, as opposed to power distribution (Baker and McKenzie, 2015). As for public infrastructure procurement (aside from PPPs), foreign contractors can only bid for "foreign-assisted projects" that are funded from ODA grants and loans (KPMG, 2014).

Figure 5.3. **Private investment in projects by sector and contract type, 1990-2014**
(USD million)

Source: World Bank Private Participation in Infrastructure Database, 2014.

StatLink http://dx.doi.org/10.1787/888933345161

The proportion of foreign investments in infrastructure sectors is therefore lower in the Philippines than in most other ASEAN countries. The majority of projects of the PPP pipeline awarded so far have been secured by domestic conglomerates or consortiums including domestic companies. Likewise most project financing has been conducted locally (Baker and McKenzie, 2015). This can be a positive outcome provided that domestic companies and financial markets are well suited to the needs of long-term, highly technical and often large-scale infrastructure projects; but foreign investment can also bring important benefits, including technology transfer and longer-term expertise in terms of PPP management and roll-out. Restrictiveness may also pose particular problems for large-scale projects where domestic financing does not suffice. One of the biggest projects in the current PPP pipeline, a USD 8.7 billion mass transit system to connect Manila's two main business districts, may run into difficulties if it must rely on local financing alone (Moss, 2015). The fact that foreign investors face more complex rules in terms of accessing and financing infrastructure projects in the Philippines, including via PPPs, may in part explain why only a small portion of the full PPP pipeline has secured investor interest and been awarded to date.

Learning from past experiences of public-private investment

Earlier PPP and concession attempts in the Philippines had a mixed track record. The government tended to take on excessive risk in past contracts (particularly foreign exchange and demand risks), to extend overly generous guarantees, and to shoulder heavy contingent liabilities. For example the power purchasing contracts established in the early 1990s, which took the take-or-pay form to allay investor concerns about future electricity demand, bound NPC to heavy power purchasing costs for capacity that exceeded market demand. Fiscal costs have also been very high for the Manila Metro Rail Transit project, which guaranteed 15% equity returns in dollar terms to project sponsors; in practice these levels have been difficult to reach, especially given the high subsidisation of transport tariffs (KPMG, 2015). These costs were further heightened following the 1997 Asian financial crisis, given the dollar denomination of these schemes.

Excessive use was also made of unsolicited proposals, in part due to the lack of a clear legal framework for private participation in infrastructure. The associated risks were further exacerbated by low project preparation capacity within sector agencies, opening the way for corruption and excessive risk-taking in infrastructure contracts (KPMG, 2013). Unsolicited bids have been prevalent in the transport sector, where only a few investment projects to date have been developed using an open, competitive bidding process and embedded within a prioritised transport investment programme. The Metro Rail Transit project resulted in the public party shouldering too much of the demand, commercial, performance, and financial risks of the project (ADB, 2012).

The need for a more comprehensive legal and institutional framework for private investment in infrastructure has thus become increasingly apparent. To improve on this initial experience, since 2010 the Philippines has re-launched its PPP programme, and substantially improved transparency and risk management within its legal framework for infrastructure procurement (Table 5.2). Between December 2011 and June 2015, the government awarded ten PPP projects amounting to USD 4.2bn to private sector partners (Table 5.1). The premium bids totalled USD 1.5bn for six out of these awarded projects. Moreover the current PPP pipeline is very ambitious and comprises 54 projects. Among these, the largest project is the North-South Railway Project (South Line, amounting to USD 3.8bn), which has been approved by the NEDA-ICC and NEDA Board and as of August 2015 was at the bidding stage. The full PPP pipeline, including the detailed status of all projects, is publicly available on the PPP Centre’s website.

Despite this success in re-launching the momentum for PPPs, private participation has lagged behind in several sectors. For example the power sector continues to face difficulties in attracting private investors, leading the PDP 2011-16 to call for “establishing triggers to allow government to build power plants in face of weak private sector interest”. The 24% drop in investments registered with the BOI over 2013-14 has largely been attributed to fewer applications for energy-related projects in 2014 (WBF, 2015). The strict rules for foreign participation in many infrastructure sectors may also have undercut private interest in part of the PPP pipeline (Baker and McKenzie, 2015).

Table 5.1. **PPP pipeline: Status of awarded projects as of August 2015**

Project	Cost estimate (USD)	PPP Structure	Status	Private proponent
Daang Hari-SLEX Link Road Project	44.6M	Build-Transfer-Operate (BTO)	Construction ongoing; Start of operation: 24 July 2015; and Initial Toll Rates for Muntinlupa-Cavite Expressway published on 11 July 2015	Ayala Corporation
PPP for School Infrastructure Project (Phase I)	365M	Build-Lease-Transfer (BLT)	Construction ongoing. As of 31 July 2015: 9 103 classrooms (98%) completed and delivered.	Consortium of BF Corporation (Riverbanks Development Corp.); and Citicore Holdings Investment, Inc.(Megawide Construction Corp.)
PPP for School Infrastructure Project (Phase II)	85.82M	Build and Transfer (B&T)	Issuance of Invitation to Bid on 20 March 2013. As of 30 June 2015: 1 277 classrooms (29%) completed; with ongoing construction (36%); in pre-construction phase (35%).	Megawide Construction Corporation and Consortium of BSP Co. Inc. and Vicente Lao Construction
NAIA Expressway (Phase II)	352.49M	Build-Transfer-Operate (BTO)	Date of Award: 14 May 2013; Contract Signing: June 2013; Construction ongoing: 44.53% complete as of 20 July 2015.	Winning bidder: Optimal Infrastructure Development Corporation (SMC); & two project contractors (Matiere SAS and DMCI)
LRT Line 1 Cavite Extension and O&M	1.44B	Build-Transfer-Operate (BTO)	Bid submission on 27 May 2013; Ongoing pre-handover and pre-construction activities; Ongoing procurement of independent consultant.	Light Rail Manila Corporation (consortium of Ayala Corporation, Metro Pacific Light Rail Corporation & Macquarie Infrastructure Holdings)
Modernisation of Philippine Orthopedic Center	193.11M	Build-Operate-Transfer (BOT)	Bid submission 26 April 2013; On-going procurement of Independent Consultant; Awaiting issuance of Certificate of Possession for the Project Site	Megawide – World Citi Consortium
Automatic Fare Collection System	38.22M	Build-Own-Operate (BOO)	Pre-qualification submission on 12 April 2013; Ongoing pre-operation activities (*i.e.* Installation of equipment & machines, operational readiness test).	AF Consortium

Table 5.1. **PPP pipeline: Status of awarded projects as of August 2015** (cont.)

Project	Cost estimate (USD)	PPP Structure	Status	Private proponent
Mactan Cebu International Airport Passenger Terminal Building	389M	Build-Rehabilitate-Operate-Transfer	Pre-qualification submission on 05 April 2013; Construction ongoing; Ground-breaking Ceremony held 29 June 2015.	GMR Infrastructure and Megawide Consortium
Cavite-Laguna Expressway	1.23B	Build-Transfer-Operate (BTO)	Contract signed on 10 July 2015; ongoing procurement of independent consultant and negotiation.	MPCALA Holdings, Inc.
Southwest Integrated Transport System (ITS) Project	55.56M	Build-Transfer-and-Operate (BTO)	Concession Agreement signed 24 April 2015; ongoing pre-construction activities & procurement of independent consultant.	MWM Terminals, a consortium of Megawide Construction Corp. and WM Property Management Inc.

Source: PPP Centre, Philippines, 2015. http://ppp.gov.ph/

Structural and regulatory constraints may therefore be limiting investor interest in some infrastructure sectors, despite a favourable regime for PPPs as well as for independent power provision. To better understand these constraints, the following section briefly investigates key features of the enabling environment for infrastructure investment in the Philippines, in particular: (*i*) the space made for state-owned and private infrastructure operators in key infrastructure markets; (*ii*) the economic regulation of these markets (further detailed in Chapter 4); and (*iii*) the legal and institutional framework for managing private participation in infrastructure, notably via PPPs. These elements can all affect the level and certainty of returns for prospective investors and therefore the country's ability to attract the private participation called for in the PDP 2011-16.

Scope for private participation in Philippine infrastructure markets

Where private infrastructure providers coexist with state-owned incumbents, particular measures to maintain a level playing field may be needed to safeguard a healthy competitive environment and reduce concerns over regulatory discretion and risks. This section limits itself to describing the extent to which state-owned enterprises remain active in key infrastructure sectors, as well as ongoing efforts to make more space for private participation.

Bodies tasked with competition policy and with economic regulation of infrastructure sectors can also exert pressure on public and private infrastructure providers to perform efficiently and enhance market competitiveness. The roles of competition agencies and sector regulators active in these infrastructure markets therefore deserve attention. A well-designed procurement regime in which the competition authority plays an active role can help guarantee procedural fairness to all investors and minimises the risk of corruption, bidder collusion and bid-rigging. Competition agencies can moreover help maintain an open and non-discriminatory regime downstream of infrastructure markets. Sector regulators, in turn, can enhance investor certainty regarding infrastructure tariffs and returns; this requires that they be competent, well-resourced, and shielded from undue influence by the parties to infrastructure contracts. These considerations are briefly explored below (Boxes 5.3-5.7), and further expanded in Chapter 4.

Power sector

The *Department of Energy Act* of 1992 (RA 7638) created the Department of Energy (DOE) as the body primarily responsible for the preparation, integration, co-ordination, supervision, and control of all government plans and programmes relative to energy exploration, utilisation, distribution, and conservation. A decade later, the *Electric Power Industry Reform Act* (EPIRA) of 2001 (RA 9136) set the main lines for reform of the power sector and its progressive openness to private participation. Three components of the power sector (generation, transmission and distribution) have accordingly been unbundled since:

- The generation of electricity is conducted by the state-owned National Power Corporation (NPC), under the ‘single buyer model’ where it buys part of its power supply from IPPs. Since 2001 the Power Sector Asset Liability Management Corporation has assumed NPC’s generation assets in view of eventual privatisation, and manages its liabilities. By end 2014 it had bid out over 68% of NPC generation contracts to IPPs (KPMG, 2015).

- The National Transmission Corporation (TransCo) was created by EPIRA as a government agency to operate and manage the power transmission system, but the same act also mandated its privatisation. In 2007 the TransCo concession was thus awarded to the National Grid Corporation of the Philippines, which manages and operates the nationwide transmission system (including between islands). Meanwhile TransCo retains ownership of all transmission assets.

- Electricity distribution to end-users is carried out by privately-owned electric utilities, local government-owned utilities and electric co-operatives located within their franchise areas.

Box 5.3. **Regulation of the Philippine energy sector**

An Energy Regulation Board was set up in 1976 but only charged it with exploration and exploitation of natural resources, including gas and petroleum. Today, the Electricity Regulatory Commission (ERC) oversees the sector but is not independent; as stipulated in the EPIRA 2001, ERC members are appointed by political authorities. Alongside, the National Renewable Energy Board was convened pursuant to Section 27 of RA 9513, which promulgates the 2008 *Renewable Energy Act*.

To date ERC approves but does not set tariffs itself. Cases brought before ERC are publicly available, such as in the annual EPIRA Implementation Status Report (DOE, 2014). ERC is perhaps the most advanced of the sector regulators in terms of addressing market competition concerns. The ERC issues “Competition Rules and Complaint Procedures” addressing anticompetitive agreements (see Chapter 4); it is investigating alleged price manipulations in the wholesale electricity market (in 2006) and alleged collusion among generation companies to fix prices (in 2013, in collaboration with the OFC).

The ongoing reforms for Retail Competition and Open Access would considerably affect ERC tariff-setting functions. It would create a single electricity market composed of wholesale and retail components and allow power suppliers to directly transact with electricity end-users. Prices charged by both the generation company and the suppliers would thus be competitive and not subject to ERC regulations. Only charges in transmission and distribution of electricity will remain fully regulated by the ERC. In this regard, DOE and ERC would have to combine policies on open access (KMPG, 2014). More broadly, clarity of roles between ERC and the DOE would have to be better defined, and the PDP 2011-16 suggests reviewing the regulatory setup of the sector. Given the number of pre-requisites needed for an effective switch to RCOA (including the ability of retailers to source generation and of customers to switch efficiently between suppliers), a number of other transitional issues need to be addressed to implement the scheme (Reyes, 2013).

Sources: DOE, 2014; Reyes, 2013; & KPMG, 2014.

Within this framework, electricity end-users bought power only from their local distribution utility. Since 2012 the Philippines has started implementing Retail Competition and Open Access in the energy sector, which would give the power industry a fourth major sector: the supply sector, composed of retail electricity suppliers and local electricity suppliers.

Full implementation would have important implications for market competition and regulation (Box 5.3).

Space has also been made for private participation in renewable energies, an essential step towards reducing the country's heavy dependence on fossil fuel imports, while contributing to job creation. The renewable energy potential of the Philippines is estimated at about 150-250 GW. Yet beyond major production of geothermal energy, other renewable energies (solar, wind and hydropower) have long remained relatively untapped. Accordingly EO 232 of 2000 amended EO 462 of 1997 with the aim of "enabling private sector participation in the exploration, development, utilisation and commercialisation of ocean, solar and wind (OSW) energy resources for power generation and other energy uses". The DOE is to further development and use of OSW energy resources "through the participation of the private sector under production sharing contracts". More recently, the *Renewable Energy Act* of 2008 (RA 9513) mandates establishing a feed-in tariff system for electricity produced from OSW, run-of-river hydropower and biomass, and provides for (mostly fiscal) incentives for such projects.

Telecommunications sector

The Philippine telecommunications sector is an important element of the local economy, having contributed over 10% of GDP for several years, and set to grow further in support of the rapidly expanding BPO-ICT industry. The provision of telecommunications to the public is governed by laws on public utilities and, like the other core infrastructure sectors, it is subject to franchise and licensing requirements as well as a nationality restriction. Specific transactions such as the sale or lease of franchises require prior government approval. The *Public Telecommunications Policy Act* (RA 7925) moreover poses obligations pertaining to universal access, interconnection, competition, public ownership of telecommunications enterprises and protection of end-user rights. Fewer obligations and less oversight by the national regulator (see below) apply to "value-added services" such as the internet.

The Philippines Long Distance Telephone Company, PLDT, was founded in 1928 and, after several decades of private ownership, was placed under government control in 1967 and given a virtual monopoly over domestic as well as international services. A wave of reforms began with the Service Areas Scheme in 1993 to stimulate network expansion and to counter market dominance by PLDT. In 1995 the *Public Telecommunications Policy Act* divided the Philippines into 11 regions which were opened to direct competition with PLDT. This brought in several foreign investors, although many later withdrew in the wake of the

Asian Financial Crisis. In 2002 the Scheme was abandoned, in part because the use of narrow franchise areas was leading to network overbuilding in some zones, while preventing new operators from reaching economies of scale and competing effectively with PLDT (Zita, 2005). Today PLDT's subsidiary, Smart, remains the dominant player in the market: by 2011 it held a 52% share, followed by Globe Telecom with 32% and Digitel with 16%; Smart's acquisition of Digitel (approved, subject to strict conditions, by the regulator NTC) raised its share to 67% of the mobile market by early 2013.

Box 5.4. **Regulation of the Philippine telecommunications sector**

The National Telecommunications Commission (NTC) oversees the telecommunications sector, with a focus on fixed and mobile telephony. It took over from the Board of Communications and the Telecommunications Control Bureau under EO 546 (July 1979).

The NTC's quasi-judicial functions and decisions are appealable only and directly to the Supreme Court of the Philippines. But on other grounds the agency is not independent. Where its regulatory functions are concerned (granting of licences, accepting radio communications, etc.), NTC remains under the administrative supervision of the DOTC as an attached agency. This can create scope for a blurring of responsibilities. Political interference with key appointments, and the absence of long-term employment contracts to protect regulators from political dismissal, were common in the mid-2000s, according to Zita (2005). NTC moreover has little power to regulate the price of internet, which under Philippine law, is still a value-added service and not a basic service (thus not subject to NTC regulation). NTC's antitrust mandate prescribed by the *Public Telecommunications Policy Act* is rather broad but, unlike in the energy sector, NTC has not yet established equivalent competition rules and guidelines required for effective implementation.

The PDP 2011-16 calls for a Department of Information and Communications Technology (DICT) while strengthening the capacity of NTC to respond to technological and market changes, including the growing importance of the internet, and enhancing the political independence of its members as well as its fiscal independence. DICT creation (as a department which would supersede the existing DOTC) has been announced since 2004 and is still pending, despite several draft bills. The Commission on Information and Communications Technology was created following an executive order in 2004 as a 'de-facto DICT', but abolished in 2011. IT directives were instead moved to the Department of Science and Technology.

Sources: PDP 2011-16; Zita, 2005.

As regards internet and connectivity more broadly, though the sector is liberalised and has been expanding in recent years, the Philippines fares quite poorly compared to ASEAN neighbours. According to the *Network Readiness Index* of the World Economic Forum, the Philippines slid from 58th place overall to 78th out of 148 countries in 2014 (WEF, 2014b). Internet affordability is particularly low, fixed broadband internet tariffs placing at 82nd worldwide (with USD 35 per month), and among the most expensive of the ASEAN region.

Transport sector

The Philippines transport sector is of comparatively low quality relative to other ASEAN countries, prompting a large increase in public spending in various sub-sectors (especially road and rail) after years of under-investment. The geographic particularity of the Philippines as an archipelago, combined with growing urbanisation, has made accessibility between, and mobility within, islands a priority for the national transport system. Intermodal integration remains poor, in part due to weak sector governance and institutional capacity; and private investment in transport infrastructure remains relatively low. Although private investment flows to the sector actually exceeded the level of public spending over 1998–2007 (standing at 1.9% of GDP compared to 1.6% of GDP for public investments), they were mostly the result of unsolicited bids and did not take place within a unified partnership framework. Private investment in the transport sector has declined since (ADB, 2012; see also Figure 5.2).

In the rail sub-sector, the state-owned Philippine National Railways is an agency of the Department of Transportation and Communications. It operates a single line of track on Luzon, lines in other regions having been non-operational for several years; and as of 2010, it also operates one commuter rail service in Metro Manila and a second in the Bicol Region. Manila's metro services have been integrated through the Strong Republic Transit System, which also incorporates light rail transport. The state-owned Light Rail Transit Authority operates two light rail lines while a third was financed and constructed by a private entity, the Metro Rapid Transit Corporation, under a build–lease–transfer agreement. Meanwhile road-based public transport in Manila and in other urban areas is provided entirely by the private sector.

The water transport sub-sector is particularly important in the Philippines – notably for inter-island transport. In 2012 about 1 000 of the 1 300 ports in the Philippines were government-owned, and the rest were privately owned and managed. Private investors played a key role in bringing about policy changes to support the development of the roll-on-roll-off system (Llanto & Navarro, 2014). There is also a variety of public and private ownership and operation in the air transport sub-sector, where out of 215 airports in 2012, 84 were government-owned and controlled and the rest privately owned and operated. As part of efforts to further liberalise air transport, the government is negotiating bilateral "pocket open skies" agreements for secondary airports in the Philippines; private investor mobilisation has been an important contributing factor to this reform. There is therefore significant competition between publicly and privately owned operators in road, port and aviation sub-sectors – but with risks of conflicts of interest given the lack of independent regulation in these sectors (ADB, 2012; Box 5.5). Some of these elements are further detailed in Chapter 4, in particular as regards competition in the domestic shipping industry.

Box 5.5. **Regulation of the Philippine transport sector**

In transport, sector regulators include the Toll Regulatory Board, the Maritime Industry Authority, and the Civil Aviation Authority of the Philippines. The PDP 2011-16 notes that there are "overlapping and conflicting functions of transport and other concerned agencies". The PDP commits to restructuring the port, rail and air transport agencies by removing their dual roles (as they are currently involved in the provision of transport infrastructure and services, as well as in regulation) and by rather establishing a separate and independent regulator (or regulators) with jurisdiction over all airports, ports, or railways. This follows in part on the previous PDP which proposed a Strategic Rail Authority within (or preferably at arm's length from) the Department of Transportation and Communications for policy, strategy, and regulation of the rail sub-sector. Reforms towards more regulatory independence are still pending and would be particularly important given the coexistence of, and competition between, state-owned and private infrastructure providers in the road, air and water transport sectors.

Sources: PDP 2011-2016; Rappler, 2014.

Water sector

Most expenditure in the Philippines water and sanitation sector is undertaken through the following:

- The Department of Public Works and Highways (DPWH), mostly related to flood management;
- The Metropolitan Waterworks and Sewerage System and the Local Water Utilities Administration (LWUA), which are both state-owned companies attached to the DPWH; and

- Two private concessionaires in Metro Manila, following the privatisation of the Metropolitan Waterworks and Sewerage Systems in 1997.

Water and sanitation investments funded by national government agencies declined dramatically in Metro Manila after 2007, as private concessionaires began to fund more investments (ADB, 2013). Public spending has recovered somewhat since, but remains at around PHP 3-4 billion per year – one of the lowest infrastructure-related spending items on the government budget and only half of the annual investment needed to expand access to safe water to the growing population (which is estimated at PHP 6-7 billion, or USD 150–175 million; Porciuncula, 2014). The World Bank projects that the Philippines would need PHP 93 billion (USD 2.1 billion) in investments until 2025 to provide universal access to water. LWUA and MWSS have multiplied calls for private investments to help extend water and sanitation systems country-wide, but the lack of a coherent regulatory framework for such investments (Box 5.6) as well as high upfront costs, have discouraged private investors to date.

Box 5.6. **Regulation of the Philippine water sector**

The National Water Resources Board (NWRB) has the legal mandate for sector governance. It provides regulatory guidance to the sector, acts as an appellate body for providing alternative dispute resolution mechanisms, serves as economic regulator for private utilities, and reviews tariffs in collaboration with the LWUA (as a specialised lending institution and provider of technical services) and local government units. Meanwhile the Subcommittee on Water Resources was initially created under NEDA-InfraCom and has since been empowered with an expanded mandate as the key policy co-ordination body for the water sector.

However as recognised by the PDP 2011-16, the existing structure and budget of NWRB limit the exercise of its functions, and there is some overlap with the functions of the LWUA. The water sector remains weak in terms of regulation and allocation of water resources. LWUA and MWSS have noted that the absence of a strong, unified regulator for national water provision poses a challenge for further private participation in the sector. As a result when providing water to towns and cities, local governments generally partner either with LWUA in organising water districts (which are GOCCs), or with line ministries, or invest on their own to provide water to their constituents (Philexport, 2012). Currently the Philippines thus counts about 1 600 local governments but only 500 water districts and 100 small-scale providers, leaving over a thousand local governments to run their own water systems despite having no specific expertise in this area (Rappler, 2014). The PDP calls for developing a lead agency for the entire water sector and for strengthening regulatory functions of NWRB in the meantime.

Sources: PDP 2011-16; Philexport, 2012; Rappler, 2014.

Legal and institutional framework for private investment in infrastructure

The legal and institutional framework should facilitate contract enforcement and the functioning of infrastructure partnerships. Infrastructure projects are long-term with high up-front capital costs; as such, they are natural candidates for contract renegotiations due to the variability of underlying economic conditions over the project lifetime. The number of failed PPPs in infrastructure sectors worldwide attests to the difficult challenges facing policy makers and investors in this respect. The Philippines has had its share of distressed PPPs, often because of excessive commercial and demand risk taken on by government (especially in the context of unsolicited bids). A few infrastructure investment disputes have escalated – for instance, arbitration proceedings for the USD 300 million contract of terminal 3 of the Ninoy Aquino International Airport have recently been resolved before the International Centre for Settlement of Investment Disputes (ICSID).[3]

The current section highlights the many improvements that have been brought about to the legal and institutional framework specific to public procurement and PPPs. Several special funds have also been established to facilitate PPP project preparation and financing (Box 5.7). If these reforms – and their associated financing mechanisms – are effectively implemented and used in the coming years, they can serve as effective signalling mechanisms for potential investors while striving for more prudent risk sharing (and thus more successful projects) among public and private parties.

Legal framework for infrastructure procurement and PPPs

Table 5.2 below outlines the key laws and regulations relevant to private participation in infrastructure in the Philippines. The *Commonwealth Act* No.146 of 1936 was one of the earliest laws to lay down possibilities of delegation of public services to private operators, through “franchises” (or concessions). The more recent legal framework for public procurement includes the *Government Procurement Reform Act* (GPRA) of 2003 and the *Local Government Code* of 1991.

Box 5.7. **Funds established to support PPP project preparation and bankability**

Special funds established to support PPP development in the Philippines include:

- The Strategic Support Fund: the government provides a lump sum appropriation in the annual budgets of implementing agencies engaged in PPP to fund the government's share for PPP project components. The budget can be used for right-of-way acquisition, provided that these do not exceed 50% of total project costs.

- The Project Development and Monitoring Facility (PDMF): established with a P300 million (about USD 7 million) allocation from the Philippine Government and USD 6 million from the Australian Government, and administered by the ADB, the PDMF aims to facilitate pre-investment activities of potential PPP projects (such as undertaking the pre-feasibility and feasibility studies and developing a robust pipeline of PPP projects for central agencies as well as local governments). The PDMF Board as well as the PPP Centre and NEDA are all involved in this process, and it is understood that the winning bidder is to reimburse all the project related costs covered by the PDMF, once the bid is secured. All main infrastructure sectors, as well as education, health, tourism and various industrial activities, are eligible for PDMF support as itemised in the 2011 PDMF Guidelines.

- The Philippine Infrastructure Development Fund was established in 2010 and involves more than USD 100 million from several state-owned financial institutions.

The government also provides cost-sharing support to BOT projects that have difficulty sourcing funds, by partially financing them with direct government appropriations and/or official development assistance financing within the limit of 50% of project cost. Other related forms of government support include credit enhancements such as currency convertibility, direct government subsidies or equity. Under requests from the PPP Centre, the government has moreover included provisions for establishing a Contingent Liability Fund in the 2015 *General Appropriations Act*.

Source: ERIA, 2014; Baker and McKenzie, 2015.

Table 5.2. **Legal framework for private participation in infrastructure, 2014**

General investment law / code	Foreign Investment Act 1991 (RA 8179) Omnibus Investments Code 1987, as amended (EO 226, providing fiscal incentives) EO 78 (alternative dispute resolution, for all PPP, BOT and JV agreements between government and private entities) CA 146, as amended (Public Service Act – limits foreign equity to 40% for operation of public utilities) RA 8974 (Acquisition of Right of Way)
General procurement law(s)	Procurement Reform Act Local Government Code 1991 (RA 7160) Government Procurement Act (RA 9184) & rules and procedures of EO 423 (2005)
Specific PPP law	BOT law, 1990 (RA 6957); Amended BOT law (RA 7718)[4]: BOT implementing rules and regulations (BOT-IRR) 2012; EO 136 (transforming BOT Centre into PPP Centre)[5] MC 2011-16 (providing a PPP Sub-Committee in the LDC)
Specific PPP Policy	NEDA 2008 guidelines, for joint venture agreements with private entities (issued in 2008 and revised in 2013, these provide the rules and procedures for the competitive selection of private joint venture partners; the private partner can entirely take over a project after the government divests itself of any interest in it).
Sector-specific laws / local government laws	Legal Mandates of Sectoral Regulatory Agencies RA 7160 DILG (Local Government Code) Department of the Interior and Local Government (DILG) Memorandum Circular No. 2010-16, providing for the creation of PPP Units/sub-committees at the local level Commonwealth Act No.146 of 1936 (Public Service Law, regarding the supervision of public services and their franchises / concessions)
Dedicated institutions for PPPs / infrastructure investment	PPP Centre PPP Governance Committee NEDA-ICC and NEDA-Infracom

Source: OECD, Philippines PPP Centre, & ERIA, 2014.

The GPRA was an important step in streamlining the regulatory environment for procurement, as it rationalised over 100 laws, regulations and executive orders and enhanced the transparency of the system. Article 3 of the GPRA moreover provides for procurement by electronic means, which can be an important means of mitigating corruption risks and which has generated important cost savings for several procuring entities (in particular the Department of Health and the national oil company; PWI, 2005). Standard bidding documents for infrastructure projects have also been released in accordance with the Implementing Rules and Regulations of the GPRA, simplifying the procurement process and making it more legible.

Beyond this general procurement framework, legislative reforms have also been pursued to facilitate PPPs and concessions. The *Build-Operate-Transfer Law* of 1990[6] mobilises private resources "for the purpose of financing the construction, operation and maintenance of infrastructure and development projects normally financed and undertaken by Government". Its first amendment, in 1994, brought several improvements by: allowing for new forms of PPPs in developing infrastructure;[7] expanding incentives granted to private contractors; clarifying guidelines on PPP execution; improving project processing mechanisms; and establishing clearer governance and accountability measures. The BOT law was again amended and supplemented in 2012 by Republic Act 7718 and its implementing rules and regulations (BOT-IRR), which provides rules and regulations with respect to, among others: project preparation, bidding and approval; unsolicited bid management; performance management during project operation; and ensuring a reasonable rate of return for investors, including possible adjustments to tolls, fees, rentals and charges during the life of the contract.

The BOT-IRR also includes important elements for embedding public-private infrastructure projects within broader infrastructure development plans. It requests that government agencies: (*i*) identify in their development programmes the priority projects that may be pursued through BOT-IRR authorised schemes; and (*ii*) ensure consistency of these projects with the Philippine Development Plan, the Public Investment Programme, and the Comprehensive and Integrated Infrastructure Programme. These measures can help ensure that the PPP programme is not considered in isolation from other forms of infrastructure spending, and rather supports and consolidates national objectives for infrastructure development.

Taken together, this legal framework contains very useful elements for private participation in infrastructure. It could be made more powerful through some rationalisation: as the table above indicates, a multiplicity of codes, orders and regulations (some of which are sector-specific, and others which pertain to different levels of government) persists despite the streamlining since 2003. This remains a source of confusion for investors and implementing authorities alike. Alongside, several amendments could usefully be brought to the texts themselves. Several of the revisions under consideration for the BOT-IRR, together with some of their potential risks, are outlined in Box 5.8. Among important complements to the BOT-IRR, especially given the Philippines' mixed experience with arbitration and settlement of infrastructure investment disputes in the past, the authorities are also currently preparing implementing rules and regulations on alternative dispute resolution for PPPs (KPMG, 2015).

Box 5.8. **Proposed amendments to the BOT-IRR, under consideration since 2014**

Alongside possible modifications to the BOT-IRR itself, under consideration since 2014, include:

- Introducing incentives for PPP investors;
- New provisions on unsolicited proposals, including an extended challenging period;
- Formalising a new institutional structure for PPPs (including clearly spelling out the roles of the PPP Centre, the PPP Governing Board, and the Project Development and Monitoring Facility – *see below*);
- Expanding the coverage of the BOT Law, to include joint ventures as an additional form of PPP;
- Establishing government funds to guarantee the obligations of contracting authorities under PPP contracts;
- Prohibiting issuance of Temporary Restraining Orders and preliminary injunctions of lower courts on PPP investors (which was already to some extent applied under RA 8975 of 2000[8]); and
- Creating a list of "Projects of National Significance", which would be "insulated" from local laws issued among others by LGUs.

Several of the proposed amendments aim primarily to facilitate the approval and deployment of projects – but there is a risk that some such measures allow private and public partners to bypass due diligence and adequate preparation of infrastructure projects. This has already been a recurrent risk for infrastructure projects in the Philippines in the past. In a 2011 assessment, the ADB pointed out that: many infrastructure projects were not competitively tendered as PPPs; the financial viability of several projects was undermined by the unwillingness or inability of the government to carry out its contractual agreements; and a number of infrastructure projects have gone ahead as joint ventures without being subject to review and approval by NEDA-ICC (ADB, 2011). Similar due diligence risks could now arise, particularly in relation to the last two provisions listed above; the terminology would need to be very clearly specified, in consultation with LGUs, to guard against overly vague interpretations at the cost of local communities and other stakeholders.

Sources: ERIA, 2013; ADB, 2011.

In identifying, preparing and implementing these reforms, regular consultation with local communities, end-users, and the private partner is essential. This is also crucial throughout the lifecycle of individual infrastructure projects, including in the earliest phases of PPP preparation so as to accurately target end-user demands, guide project selection, and help prevent potential conflicts (as well as demand risk) from escalating. End-users can also play an important role during project roll-out, for instance for evaluating the performance of infrastructure projects.

Institutional set-up to support PPP development

On the institutional front, EO 136 transformed the BOT Centre into a PPP Centre and transferred it from within the Department of Trade and Industry to NEDA, as the central planning agency for government programmes and projects, and which comprises several committees specifically tasked with infrastructure development and its fiscal management (NEDA InfraCom[9] and NEDA-ICC[10]). This is more aligned with international best practices, the majority of PPP Units worldwide being under oversight of the Ministry of Finance or of national planning authorities so as to create a smoother and more immediate link with expenditure planning and management of fiscal risks. As laid out in Section 4 of the BOT-IRR, project-specific review and approval goes to different bodies (from Local Government Councils, through NEDA-ICC, and finally to the NEDA Board) depending on project size and nature (all negotiated projects or unsolicited bids, often viewed as riskier, go before the NEDA Board). This higher level of review for larger projects, including inter-ministerial engagement through NEDA committees, also corresponds to international best practice.

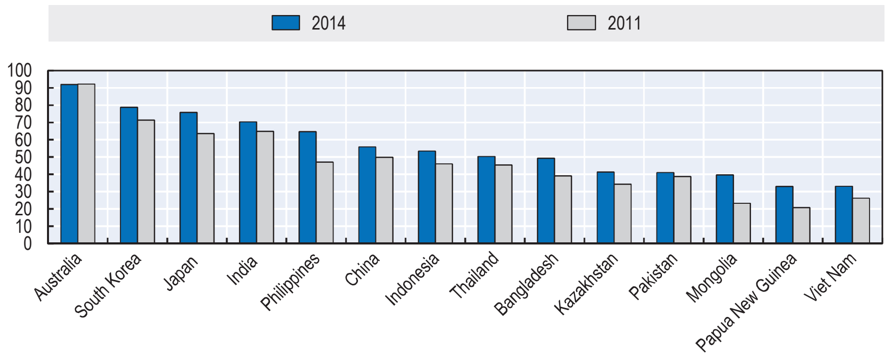
The PPP Centre, which was recently recognised by the 2014 Partnership Awards as the Best Government PPP Promoter, now serves as resource institution in the ongoing efforts of ASEAN to establish PPP guidelines for member countries. The PPP Centre is involved at each stage of the project cycle, from preparation and development to contract award and implementation. In 2013, EO 136 expanded the Centre’s mandate further to cover joint ventures and established a PPP Governing Board as the country’s overall policy-making body for all PPP-related matters, to which the PPP Centre now reports. Considerable efforts have also been undertaken to make PPP resources publicly available online, including procurement and project preparation manuals, and a Generic Preferred Risks Allocation Matrix which can serve as a valuable reference for NEDA-ICC as well as contracting agencies in their review of proposed PPP projects.

In some respects however, the institutional and financial structure described above lacks clarity and effectiveness. Assessments by ERIA in

2014 point to a need for better delineating responsibilities between the PPP Centre and the PPP Governing Board, as regards formulating PPP policy, updating PPP legal and regulatory frameworks and providing expert advice to other government agencies on PPP projects. The PPP Centre also needs more capacity in order to function as the national unit and to bring the many projects in the PPP pipeline to fruition. Relatedly, although the creation of PPP Units and sub-committees within local development councils is considered in the BOT-IRR[11], the time, resources and capacity of local authorities to engage in such efforts is limited at present. Rather than setting up units *per se*, in a first phase it could be useful for central and local government agencies to establish PPP focal points which would rely on support from the central PPP Centre in deploying projects at the local level. Going forward and once local authorities have acquired more familiarity with PPPs, greater institutional decentralisation could be considered. This more phased approach seems to underlie several of the PPP Centre's recently developed short-term and medium-term strategies at local level, including its Capacity Building Programme for LGUs and the Internship Programme and Partnerships which it is launching with selected local capacity building institutions (KPMG, 2015).

Overall, the preceding overview illustrates considerable progress in the legal and institutional framework for PPPs over recent years. This is confirmed by the strong improvements in scoring against the EIU *Infrascope* (Figure 5.4): with a total "PPP readiness" score of 64.6 in 2014, the Philippines is among the countries covered that has most improved since 2011 – in particular in the categories of regulatory and institutional frameworks, investment climate, and financial facilities for PPPs. The Philippines performs similarly to Colombia or Mexico (respectively at 61 and 67.8 in the 2014 LAC *Infrascope*). Over the past four years it has moved from *Infrascope's* classification as an "emerging" PPP market to a "developed" one; that is, possessing "accommodating institutional and regulatory frameworks", but lacking full sophistication in "managing the many challenges bought about by PPP programmes, such as technical capacity, effective dispute resolution mechanisms, the adoption of viability gap funding policies and appropriate standards for contingent liability accounting" (EIU, 2015). This assessment corresponds very closely to several of the shortcomings identified earlier in this chapter. Current reforms must be backed by transparent implementation and strong technical capacity in the public sector to further shore up investor confidence and generally revive private sector interest in infrastructure markets.

Figure 5.4. **Infrascope "PPP readiness" scores for selected Asia and Pacific economies, 2011 and 2014**



Notes: Scores are out of 100; PPP markets are considered 'mature' at 80 points and higher, 'developed' between 60 and 80 points, 'emerging' between 30 and 60, and 'nascent' below 30. The total score is compiled out of five categories measuring: the regulatory and institutional framework for PPPs; operational maturity (experience with managing PPPs); investment climate (including the general business environment and a measure of political will); and financial facilities (which includes, among others, government payment risk, capital markets, and government support for affordability by low-income users).

Source: EIU / ADB, 2015.

StatLink http://dx.doi.org/10.1787/888933345179

Notes

1. Manila Water Company was established by the consortium that won an internationally competitive tender to operate a 25-year concession for water and wastewater services in metro Manila's East Zone.
2. In 2013 the Philippines' Securities and Exchange Commission (SEC) issued a final ruling to retain a 40% foreign ownership cap in certain industry segments, including major utilities. This cap will not apply to each class of shares but to the total number of outstanding shares of stock.
3. The dispute results from alleged irregularities and discrepancies between the bid award and the commercial franchise. The Supreme Court voided the contract and took over the project from the concessionaire Piatco (KPMG, 2015).
4. Under modification since 2014, to introduce incentives for PPP investors as well as new provisions on how government would treat unsolicited proposals; and formalise a new institutional structure for PPPs. Should

also expand the coverage of BOT Law into a PPP Act, which includes Joint Ventures as an additional form of PPP scheme.

5. Proposed amendments to Executive Order No. 8 (in 2014) aim to clearly spell out the roles of the PPP Centre.

6. Otherwise known as the "Act Authorising the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector and for Other Purposes"

7. These contractual forms include: build-own-and-operate, build-lease-transfer, build-transfer-operate, contract-add-and-operate, develop-operate-and-transfer, rehabilitate-operate-and-transfer, and rehabilitate-own-and-operate.

8. RA 8974 facilitates the acquisition of right-of-way, site or location for national government infrastructure projects, in addition to prohibiting lower courts from issuing temporary restraining orders or preliminary injunctions.

9. NEDA Infrastructure Committee (InfraCom) comprises the Secretary of Public Works and Highways, as well as the Executive Secretary and Secretaries of Transportation and Communications, Finance, and Budget and Management. It advises the President and the NEDA Board on matters concerning infrastructure development, co-ordinates the activities of agencies, and recommends policies, programmes and projects concerning infrastructure development consistent with national development objectives.

10. NEDA-ICC (Inter-Agency Investment Coordination Committee) gathers the Secretary of Finance, the Executive Secretary, the Secretaries of Agriculture, Trade and Industry, Budget and Management, and the Governor of the Central Bank of the Philippines. It evaluates the fiscal, monetary and balance of payments implications of major national projects, and submits status reports of the fiscal, monetary and balance of their payments implications.

11. Department of the Interior and Local Government Memorandum Circular 2010-16

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Chapter 6.

Responsible business conduct in the Philippines

This chapter provides an overview of the responsible business conduct landscape in the Philippines, outlining the actions the government of the Philippines has taken to regulate, facilitate, promote, cooperate on and exemplify responsible business practices. It also provides recommendations for how the climate for responsible business conduct in the Philippines can be further enhanced with a view to promoting high quality investment and sustainable development.

...the business of business must also be to ensure the long-term development and sustainability of our environment. Business should also be concerned with the human resource growth of our children as future workers in the workplace.

Washington Sycip,
Chair of the Sycip Gorres Velayo & Co. Group of Companies

To the extent that the businessman's economic activities generate an imbalance in society and create social tensions he must undertake social development programmes which respond to these social problems.

Sixto K. Roxas,
Chairman, Maximo T. Kalaw Institute for Sustainable Development

Summary

The expectation that businesses should avoid and address negative impacts associated with their operations as well as contribute to sustainable development is widespread and increasingly being formalised in international trade and investment agreements, domestic law and company policy. Behaving responsibly often also represents a competitive advantage for businesses. Governments can provide an enabling framework for responsible business conduct (RBC) through regulation, promotion and facilitation, co-operating with relevant stakeholders, and exemplifying responsible practices within their own role as an economic actor. The Philippines has a long-standing culture of corporate philantrophy and some progressive legislation and initiatives in place to promote and support RBC. Efforts to further improve the RBC climate in the Philippines could contribute to attracting and retaining quality investors and promoting sustainable development.

The Philippines has a long history of corporate philanthropy and corporate-community engagement rooted in the concept of '*bayanihan',* a part of Philippine culture reflecting values of brotherhood and mutual aid. The state is active in promoting this culture through government and non-government initiatives, but good corporate citizenship continues to be viewed predominantly as a concept rooted in philanthropy, rather than as a core responsibility and function of business. To strengthen the environment for RBC, governments can emphasise the expectation that companies avoid and address adverse impacts and contribute to sustainable development.

The Philippines has regulations in place for protecting public interest and underpinning RBC. Certain challenges with regard to adverse impacts linked to business activities persist, however, despite government efforts to address them – particularly concerning community displacement, labour and employment, environmental issues and corruption. Reforming regulations which impede RBC and enhancing oversight to ensure those that promote RBC are adequately implemented in practice could strengthen responsible business practices in the Philippines.

Mainstreaming policy on RBC and developing a communications strategy to clearly explain expectations concerning business behaviour could also be helpful in facilitating responsible conduct among businesses operating in the Philippines. Alignment with international standards such as the OECD *Guidelines for Multinational Enterprises* ('the OECD *Guidelines'*) or other widely recognised standards on RBC could signal the government's commitment to RBC and provide a well-recognised framework of expectations on RBC for investors.

Scope and importance of responsible business conduct

Responsible business conduct means that businesses should make a positive contribution to economic, environmental and social progress with a view to achieving sustainable development and should avoid and address adverse impacts through their own activities as well as prevent or mitigate adverse impacts directly linked to their operations, products or services by a business relationship. While the concept of corporate social responsibility (CSR) is often associated with philanthropic corporate conduct external to business operations, RBC emphasises integration of responsible practices within internal operations and throughout business relationships and supply chains. Due diligence is the process a company uses to meet its responsibilities in this regard. Businesses are expected to carry out due diligence to identify, prevent and mitigate risks of adverse impacts and account for how those impacts are addressed when they do occur.

The expectation that business should manage environmental and social risks throughout their operations has increased with the development and recognition of international standards such as the UN *Guiding Principles for Business and Human Rights* and the OECD *Guidelines* (Box 6.1). This expectation is not only reflected in international instruments but is increasingly being integrated into national legislation. For example, a proposal currently under consideration in the French Senate aims to mandate that companies over a certain size engage in due diligence throughout their supply chains in accordance with the OECD *MNE Guidelines* (Assemblée Nationale, 2015). Furthermore, the inclusion of language related to sustainable development or the promotion of responsible business conduct in investment treaties has become common practice in recent years. More than three-fourths of recently concluded international investment agreements (*i.e.* between 2008 and 2013) contain language on RBC.[1] Virtually all of the investment agreements concluded in 2012 and 2013 include such language (OECD, 2014).

Box 6.1. **OECD Guidelines for Multinational Enterprises**

The OECD *Guidelines for Multinational Enterprises* are recommendations jointly addressed by governments to multinational enterprises. They aim to ensure that the operations of these enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises.

The *Guidelines* are aligned with the UN *Guiding Principles for Business and Human Rights* and include a general principle on the need to exercise due diligence to avoid or mitigate negative impacts on third parties, notably with respect to the management of supply chains and other business relationships.

The recommendations of the *Guidelines* cover all major areas of corporate responsibility, namely:

- disclosure,
- human rights,
- employment and industrial relations,
- environment,
- combating bribery, bribe solicitation and extortion,
- consumer interests,
- science and technology,
- competition, and
- taxation.

The *Guidelines* comprise a distinctive implementation mechanism, the National Contact Points (NCPs), which are government offices charged with advancing the *Guidelines* and handling enquiries in the national context and supporting mediation and conciliation procedures, called “specific instances”.

Beyond emerging global expectations, businesses are learning that environmental and social risks, including human rights risks, can pose material threats to their business operations. Such threats include serious reputational damage, opportunity costs in the form of lost future expansions or partnerships and direct costs arising from damages or compensation paid as a result of adverse impacts, lost productivity due to temporary shutdowns and senior staff time being diverted to manage grievances. As a result of these potentially significant implications, institutional investors are assessing the social and environmental effects of their investments. Governments that do not enforce or facilitate responsible business practices risk seeing their economy marginalised or excluded from global supply chains.

All parties – including both businesses and governments – have a role to play in building a healthy business environment. While businesses are expected to act responsibly, governments have a duty to protect the public interest from potential negative effects of business activities and a role in providing an enabling environment for businesses to act responsibly. To the extent that governments fulfil this role, they are more likely to attract and retain high quality and responsible investors and hence to ensure broader value creation and sustainable development.

Governments can enable RBC in several ways:

- *Regulate* – establish and enforce an adequate legal framework that protects the public interest and underpins RBC, and monitor business performance and compliance with regulatory frameworks;
- *Facilitate* – clearly communicate expectations on what constitutes RBC, provide guidance on specific practices and enable enterprises to meet those expectations;
- *Co-operate* – work with stakeholders in the business community, worker organisations, civil society, the general public, across internal government structures, as well as other governments to create synergies and establish coherence with regard to RBC;
- *Promote* – demonstrate support for best practices in RBC;
- *Exemplify* – behave responsibly in the government’s role as an economic actor.

Progressing beyond corporate citizenship centred on philanthropy

Corporate citizenship has historically been a part of business culture in the Philippines and is actively promoted by the government. In a survey of 166 business executives of companies operating in the Philippines, 82% agreed that good corporate citizenship helps the bottom line, 59% agreed that it improves the image and reputation of the company and 53% believed corporate citizenship is important to their customers (Maximiano, 2005).[2] Philippine companies have frequently received awards for corporate social responsibility. They are consistently the leading recipients of the Asian CSR awards, granted annually by the Asian Forum on Corporate Social Responsibility, across a range of categories.[3] Additionally, Philippine businesses are proactive in contributing to community development. For example, Philippine Business for Social Progress (PBSP), a non-profit business association founded in 1970 representing over 260 Philippine businesses, collaborates with the government on private-public initiatives in the areas of health, education and the environment. Members pledge to contribute 1% of their companies' net income towards poverty reduction programmes.[4] Likewise the Philippine Business for the Environment has partnered with the government in implementing several national initiatives.[5]

The government has likewise been instrumental in instilling corporate citizenship within local business culture. The 2013 draft version *Corporate Social Responsibility Act* currently under consideration in the Philippine Congress represents a formal commitment to promote CSR in the country. Under the Act the state encourages the private sector's active participation in fostering sustainable economic development and environmental protection in the Philippines (Box 6.2).

While a culture of corporate citizenship already exists, a shift from a focus on philanthropy to one emphasising company responsibility for economic, social and environmental impacts and the contribution towards sustainable development would strengthen RBC in the Philippines. This was a key recommendation for the ASEAN region more broadly, raised by a study conducted on the nexus between business and human rights by the ASEAN Intergovernmental Commission on Human Rights (Thomas & Chandra, 2014).

Government engagement through training and awareness-raising with business leaders could usefully promote wider understanding and recognition of RBC. Educational institutions such as business schools and existing business initiatives pursing social objectives can also be important platforms for changing mentalities with regard to RBC.

Box 6.2. **Provisions of the 2013 draft of the Corporate Social Responsibility Act**

All business organisations established and operating under Philippine laws, whether domestic or foreign, are encouraged to observe corporate social responsibility.

Specifically, the 2013 draft of the *Corporate Responsibility Act*:

- Amends the Corporate Code to say that funds for CSR projects or programmes represent an exception to the rule that corporations may not retain surplus profits in excess of 100% of their paid-in capital stock.
- Maintains the full deductibility of contributions or gifts actually made or paid to accredited donee institutions in computing taxable income. (The Tax Code, referenced in the Act, provides CSR-related incentives to corporations, such as tax exemptions and deductions primarily under a clause that allows income deductions for charitable giving.)
- Mandates that the state should provide awards and recognition to business organisations for strong CSR performance.
- Mandates local government units to extend whatever assistance necessary for businesses to perform their CSR.
- Mandates that all business organisations submit a list of their CSR activities as part of their reporting activities to the Securities and Exchange Commission, Department of Trade and Industry and Department of Finance as relevant.

Tackling ongoing challenges to RBC

Protection of human rights defenders

The Philippines is a signatory to all of the major human rights conventions[6] and was one of the first nations to vote in favour of the 1948 Universal Declaration of Human Rights. The 1987 Constitution calls for establishing an independent Commission on Human Rights tasked with investigating human rights violations, providing assistance to victims and providing recommendations to Congress on promoting human rights and provision of remedy to human rights victims (CHR, 2012). In 2002, the Presidential Human Rights Committee was created to monitor adherence and compliance with international human rights instruments and report to the UN on implementation of treaty obligations (GOVPH, 2002).

Despite a legal framework recognising human rights and an oversight committee monitoring human right issues, Human Rights Watch documented several instances of attacks on anti-mining and environmental protestors and journalists in its 2013 and 2015 World Reports (HRW 2013, 2015). These reports urged the government to bring to justice any state security forces, individuals or organisations involved or complicit in human rights infringements, to ensure such infringements are reported upon and that whistle-blowers and human rights defenders are adequately protected.[7]

Agricultural investment and large scale displacement

Investment in agriculture is a longstanding industry in the Philippines and is expected to continue growing as food supply needs increase globally. Agricultural investment can be a significant source of FDI for developing economies, but large agricultural investments also pose risks of large-scale displacements of local populations, leading to a loss of livelihoods. This risk is exacerbated by insecure land tenure and a lack of a clear monitoring of land leases and concessions. In the Eastern Visayas region, for example, almost one third of the population consists of informal settlers with insecure land tenure (Oxfam, 2014).

It has been reported that some land falling under the Comprehensive Agrarian Reform Programme (CARP)[8], the national land redistribution programme, as well as forest land managed by the Department of Environment and Natural Resources (DENR) has been made available to agricultural investors through long-term leasing agreements (Pulhin & Ramirez, 2013). Civil society groups have raised concerns that such arrangements may threaten dispossession of local farmers and have recommended completing the distribution of land under CARP prior to leasing land. (Pulhin & Ramirez, 2013). The National Land Use and Management Act, which aims to address numerous laws resulting in conflicting land uses may also help address some of these issues once enacted.[9] Furthermore international standards on respecting land tenure rights could also provide a useful resource for best practices in this regard (Box 6.3).

Where agricultural investment could result in adverse impacts to local populations, proper stakeholder consultation should take place and due process regarding compensation should be respected. The Philippines is one of the only countries to explicitly recognise the concept of free prior and informed consent (FPIC) for indigenous peoples in domestic law. Nevertheless, it has been reported that a lack of oversight and clarity as to how FPIC should be obtained has led to situations where this principle has not been respected in practice (Oxfam, 2013). Additional clarity on expectations regarding FPIC, such as establishing a formal or recognised process of how companies should obtain FPIC can be useful to ensure it is properly implemented. Recognised guidance on consultation with indigenous peoples can be a useful resource in this regard.[10]

> **Box 6.3. The FAO-OECD Guidance for Responsible Agricultural Supply Chains**
>
> The United Nations Food and Agriculture Organization (FAO) and the OECD have developed guidance to help enterprises observe existing RBC standards applying to agricultural supply chains. These include the OECD *Guidelines for Multinational Enterprises*, the *Principles for Responsible Investment in Agriculture and Food Systems* of the Committee on World Food Security, and the FAO *Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security*.
>
> The model enterprise policy proposed in the FAO-OECD guidance outlines the content of these leading standards by defining responsible investment in agricultural supply chains. On land tenure rights, it recommends that enterprises:
>
> - Respect legitimate tenure right holders and their rights over natural resources, including public, private, communal, collective, indigenous and customary rights, potentially affected by their activities. Tenure rights over natural resources include rights to land, fisheries and forests as well as existing and potential water uses;
> - To the greatest extent possible, commit to transparency and information disclosure on their land-based investments, including transparency of lease/concession contract terms, with due regard to privacy restrictions;
> - Give preference to feasible alternative project designs to avoid or, when avoidance is not possible, minimise the physical and economic displacement of legitimate tenure right holders, while balancing environmental, social, and financial costs and benefits, paying particular attention to adverse impacts on the poor and vulnerable;
> - When holders of legitimate tenure rights are negatively affected, ensure that they receive fair and prompt compensation
>
> *Source:* OECD 2015a, forthcoming

Extractives sector and community conflict

The mining sector represents one of the Philippines' most significant potential investment opportunities, as untapped mineral wealth is estimated at USD 840 billion (Raymundo, 2014).[11] Investment in the extractives sector can generate large revenue flows and development opportunities but is also associated with significant social and environmental impacts and thus must be managed responsibly.

Under the *Philippine Mining Act* of 1995 companies must contribute a percentage of their operating costs to local community development (DENR, 2010). Under the 2010 Revised Implementing Rules and Regulations of the *Philippine Mining Act*, a Community Relations Record describing the character of a company's past relations with local communities, cultural appropriateness and social acceptability of its resource management strategies must be submitted with applications for various mining licences and permits (DENR, 2010). Furthermore, as a requirement for securing an Environmental Compliance Certificate, communities much reach an informed decision on the social acceptability of a mining project. Participation in the Extractive Industries Transparency Initiative (EITI) is also mandated for mining operations in the Philippines over a certain size (DENR, 2012).While the mining regulations of the Philippines include some progressive provisions, a lack of capacity and resources to effectively oversee compliance with expectations of the law as well as corruption at the level of state agencies has been reported to undermine their effectiveness (Raymundo, 2014).

Box 6.4. **Due diligence guidance in the extractives sector**

The *Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractives Sector* provides a framework for identifying and managing risks with regard to stakeholder engagement activities to ensure they play a role in avoiding and addressing adverse impacts as defined in the *OECD Guidelines for Multinational Enterprises*. The guidance also includes an assessment framework for industry to evaluate their stakeholder engagement performance and targeted guidance for specific stakeholder groups such as indigenous peoples, women, workers and artisanal and small scale miners.

Overarching recommendations of the *Guidance* include:

- Integrate stakeholder engagement into project planning and regular business operations through sharing of decision-making power with interested and affected parties.
- Practice stakeholder engagement that is driven by stakeholders through ongoing consultation and follow-through.
- A stakeholder engagement strategy which prioritises engagement with the most affected rather than the most influential stakeholders

Source : OECD 2015b.

Community conflict in relation to mining operations has been reported by civil society organisations (HRW, 2015) and can pose a risk for communities and investors alike. For example a recent study found that the cost of community conflict amounts to a loss of approximately USD 20 million a week on average for major mining operations due to lost productivity as a result of delays or stoppages (Davis and Franks, 2014). Increased attention and guidance to investors on how to conduct proper stakeholder engagement could be helpful in avoiding future issues and in expanding the mining sector in a responsible manner (Box 6.4).

Employment and labour relations

The Philippines is party to all eight International Labour Organization conventions and has been recognised as having a 'mature and stable'' regulatory framework with regard to labour rights (Bitonio, 2012). In 2013 it established the National Tripartite Industrial Peace Council as a consultative, advisory mechanism representing workers, employers and the government which is responsible for formulating and monitoring of implementation of labour and employment policies.[12] The Philippines also reformed the *Labour Code* in 2012 to institutionalise tripartism in labour relations as a state policy (RA 10395) and to formalise a conciliation-mediation mechanism for labour disputes (RA 10396). The Council has been criticised for its lack of adequate resources which has resulted in significant delays in reviewing cases of anti-union behaviour (ITUC, 2012). At the same time the Labour Standards Enforcement Framework developed in 2004 partially in response to resource constraints has been criticised for weakening implementation and enforcement of the *Labour Code* as it promotes self-regulation instead of formal inspection by the labour inspectorate (ITUC, 2012).

The right to strike is restricted under the *Labour Code*. For a strike to be lawful all other conciliation procedures must be exhausted, a mandatory 'cool-off' period must be respected and notice must be given 30 days in advance (DOLE, 2009). A union may not call a strike for issues other than a bargaining deadlock involving economic issues and grave acts of unfair labour practice as defined by law (DOLE, 2009). Penalties for illegal strikes are significant and can include a prison sentence of up to three years (DOLE, 2009). Furthermore, public sector employees have no right to strike and are not permitted to bargain over matters related to wages or other forms of remuneration. Complaints from public sector workers must be filed with the Civil Service Commission, a special body which arbitrates disputes involving public workers (ITUC, 2012).

Environmental protection

Environmental issues are of critical importance in the Philippines. Approximately one third of the population relies on natural resources, such as arable land and oceans, for its livelihood.[13] Furthermore, the Philippines is highly vulnerable to climate change, as demonstrated by a series of natural disasters in the past decade. As a result the government has stated that it is eager to improve protection of the environment and management of natural resources and sees such improvements as vital in the achievement of inclusive growth (BSP, 2015).

Domestic environmental policy is grounded in the Constitution which provides that the "State shall protect and advance the right of the people to a balanced and healthful ecology in accord with the rhythm and harmony of nature". Domestic legislation imposes standards on air pollution[14] (GOVPH, 1964), mandates environmental impact assessments[15] and encourages environmental litigation and protection through legal processes.[16] A consultative and oversight role of stakeholders has been formalised under national environmental regulations. For example the Department of Environment and Natural Resources requires public consultations as part of environmental impact assessments and the creation of a multipartite monitoring team during the implementation stage of environmentally critical projects (DENR, 1996).

The Philippines is party to the UN *Framework Convention on Climate Change*, including the *Kyoto Protocol* and several other international environmental agreements.[17] It also participates in the Greenhouse Gas Protocol.[18] Climate change adaptation and mitigation is stated as a priority area for the current administration. The government aims to develop climate/disaster-resilient infrastructure facilities to ensure resilience to disasters and mitigate the impact of climate change[19] (GOVPH, 2014).

The fisheries industry is a priority sector highlighted in the 2014 IPP, specifically with regard to strengthening regulation and boosting fishery production. However overfishing represents a serious issue in the Philippines. Lack of regulation and enforcement of fisheries laws has contributed to a decline of 90% in the quality of marine resources in certain traditional fishing areas with an estimated cost of USD 420 million in lost revenues.[20] In 2014 the Department of Agriculture issued a Moratorium on the Issuance of Commercial Fishing Vessel and Gear License and Other Clearances in response to the problem of over fishing and to return fish stocks to a sustainable level (BFAR, 2014).

The current Philippine Development Plan 2011-16 (PDP) highlights conflicting and overlapping policies with regard to environmental management and lack of capacity and resources to monitor and implement commitments as salient challenges to tackling environmental issues (NEDA, 2011). The PDP Midterm-Update includes focused interventions geared towards: (*i*) increasing adaptive capacities of communities; (*ii*) effectively managing the country's environment and natural resources for sustainability; and (*iii*) improving environmental quality to address some of these issues (NEDA, 2014).

Corruption

The Philippines has ratified the UN *Convention against Corruption* but is not a signatory to the OECD Anti-Bribery Convention. Curbing corruption is listed as a priority area under the PDP and support of private sector anti-corruption initiatives is encouraged. For example the Joint Foreign Chambers of the Philippines, a coalition of international businesses and investors operating in the Philippines, engages in the Compliance and Integrity Programs for Business, in which members pledge not to bribe public officials, to report corruption, and to embed anti-corruption into standard corporate practice (NEDA, 2011). Specific recommendations are also made to strengthen the public's role in this regard, such as establishing reporting platforms for civil society or the public to report exemplary performance or corrupt practices of the government (NEDA, 2011).

Businesses reportedly continue to face a high risk of encountering corruption in the Philippines when obtaining permits and licences as well as in accessing public utilities,[21] but progress is being made on this front. For example from 2011 to 2014 the Philippine ranking on the *Global Corruption Perception Index* improved from 105th to 85th out of 175 nations.[22] The World Economic Forum which had listed corruption as one of the top problems in doing business in the Philippines in its 2010-11 *Global Competitiveness Index Report* (WEF, 2011) recognised in its 2014 report that the efforts made by the government to combat corruption have begun to demonstrate results (WEF, 2014).

The Philippines has made significant efforts to tackle corruption and promote government transparency. Through its involvement in the Open Government Partnership, the government launched the open data portal in 2014. It has published over 660 data sets online, including information on contracting, procurement bids and processes, agency performance, tax and budget management.[23] This initiative represents an unprecedented effort by the government to improve transparency.

Non-financial reporting

The Philippine Securities and Exchange Commission requires public companies to make a statement regarding their compliance with environmental laws and regulations, but currently there are no sustainability indices or official guidelines on non-financial reporting in the Philippines (WRI & IFC, 2009).

In 2010, the Maharlika listing segment for the Philippine Stock Exchange was launched, creating listing and disclosure rules for companies that voluntarily abide by corporate governance practices beyond those required by law (Lindsay, 2012). A similar index could be developed to promote RBC through, for example, reporting obligations for environmental and social governance issues. The Philippine Institute of Certified Public Accountants has been promoting sustainable reporting and engages in training to promote environmental accounting and reporting in line with the Global Reporting Initiative. Such initiatives could be built upon in mainstreaming sustainability reporting.

Mainstreaming and achieving coherence on RBC

Mainstreaming RBC at a government level

Mainstreaming responsibilities for promoting and enforcing RBC can be challenging but can provide improved visibility on RBC issues and ensure policy coherence with regard to expectations across sectors. Currently the government has no official policy or action plan on RBC, and no specific ministry or government body is charged with overseeing this policy area. Under the 2013 draft of the *Corporate Social Responsibility Act,* local government units (LGUs) are expected to extend whatever assistance necessary for businesses to perform their corporate social responsibility. LGUs are also identified as the appropriate interlocutors or representatives to facilitate RBC with regard to other matters, such as by facilitating community involvement in reviewing social acceptability of mining operations. LGUs also have a leading role with regard to environmental management.[24] What such assistance might look like is not further enumerated, and no information on available services in this regard is readily accessible on LGU webpages or promotional material.

The 2014 Investment Priorities Plan is aligned with the updated Philippine Development Plan and includes some objectives related to RBC. For example, incentives are provided for business models that integrate low-income groups as producers, distributors, or employees and for investments that promote environmentally sound businesses practices (*e.g.* improved environmental performance in pulp and paper mills, prioritising e-vehicles). Incentives comprise 4-8 year tax holidays and waiver of duties for imported capital goods (BOI, 2014). The link to RBC can nevertheless be further strengthened under both plans. For example the current P includes little discussion of the role of the private sector and investment in promoting social welfare and environmental integrity, nor does it discuss RBC as a potential competitive advantage for Philippine industry.[25]

Clearly communicating RBC priorities and expectations

The Philippines has expressed a willingness to develop a National Action Plan on Business and Human Rights (Box 6.5) which would be useful in defining and communicating the government's priorities and anticipated actions in this area. It could also be helpful in defining objectives and their links to other policy agendas to ensure coherence on these issues. A National Action Plan on RBC could also be developed, which would incorporate human rights issues as well as topics crucial to RBC such as corruption and the environment. Many countries are taking this approach.

Box 6.5. **National Action Plans on RBC**

National Action Plans (NAPs) are strategy documents that governments are encouraged to develop as part of the state responsibility to disseminate and implement the UN *Guiding Principles on Business and Human Rights*. Several governments have already developed NAPs, namely the United Kingdom, the Netherlands, Italy, Denmark, and Spain, while Switzerland and Finland are in the process of doing so.

The OECD hosted a workshop in June 2015 on National Action Plans that brought together policy makers and experts to exchange experiences in developing NAPs and to identify best practices and important strategies, including:

- focusing on the salient issues or sectors, rather than articulating a comprehensive approach may be a more realistic and strategic first step.
- business, civil society, consumers and the general public are important stakeholders to consult during the process.
- ownership and championing of the process by one specific body is a key determinant of a successful NAP process.
- implementation of NAPs should be considered proactively, beginning at the NAP development stage.

Communicating RBC expectations through investment promotion agencies, investment agreements or through government contracting practices can also help investors understand the local standards and expectations of RBC from the point of entry and discourage entry of investors with poor social and environmental practices. The Philippines is already incorporating social and environmental standards in its international trade practices and, in December 2014, became the first country to be accepted into the EU's GSP+ programme.[26] The GSP+ is a special incentive trade arrangement for the implementation of 27 international conventions on labour and human rights, environmental protection and good governance.

Engaging in international initiatives on RBC

At a regional level, ensuring incorporation of CSR in the corporate agenda was included as one of the strategic objectives for the ASEAN Socio-Cultural Community Blueprint (ASEAN, 2009). The Philippines is an active participant in the ASEAN-CSR Network which provides opportunities for networking and exchange, acts as a venue for discussing and addressing regional issues and concerns regarding CSR, and is an advocate and capacity builder for acceptance of international norms of CSR behaviour.[27] As part of its mandate, the Network supports the adoption and implementation of the UN *Guiding Principles* through advocacy and consultative activities. The Philippines in also a member of the UN Economic and Social Commission for Asia and the Pacific (UNESCAP) which has been active in developing research and organising regional events to promote responsible business practices in the context of Asia.

At an international level, the Philippines is a national member of ISO 26000 and part of the UN Global Compact network – although in 2008, 93 companies or 85% of all members in the Philippine UNGC network at the time were delisted for failing to comply with reporting obligations.[28] The delisting was explained by the fact that Philippine companies are generally domestically oriented and thus less motivated to participate in international reporting programmes, despite potentially strong RBC performance (Knudsen, 2011).[29]

Aligning domestic policy with international instruments such as the OECD *Guidelines for Multinational Enterprises* could facilitate coherence of expectations of international investors. Current adherents to the OECD *Guidelines* make a binding-commitment to promote its recommendations among companies operating in or from their territories. As a result, the majority of global investment flows and global commerce is covered by these recommendations. By one estimate, adhering countries represent two thirds of the inward stock of FDI and 78% of the outward stock. In the case of the OECD *Guidelines,* further alignment could be achieved through adhering to the OECD *Declaration on International Investment and Multinational Enterprises* or simply through multilateral engagement and dialogue on recognised best practices.

Notes

1. The report explains that "major functions of such treaty language are, in the order of prevalence: (i) establishing the context and purpose of the treaty and setting forth basic SD/RBC principles through preamble language; (ii) preserving policy space to enact public policies dealing with SC/RBC concerns; and (iii) not lowering standards, in particular not relaxing environmental and labour standards for the purpose of attracting investment."

2. In this study good corporate citizen was defined under 6 categories: 1) providing safe and reliable products/services, 2) operating with ethical business practices, 3) working to improve conditions in the company, 4) making a profit, 5) providing jobs and 6) paying taxes, with the first two categories most highly recognised by survey respondents.

3. Asian Forum on Corporate Social Responsibility, www.asianforumcsr.com/awards/awardees(last accessed 19 May 2015).

4. Philippine Business for Social Progress. www.pbsp.org.ph/about-us/(last accessed 3 June 2015).

5. For example the Philippine Business Agenda 21 (for voluntary industry environmental action and self – regulation) in support of the national Philippine Agenda 21 under the UNDP; The Clean Air Campaign of the ADB – assisted Partnership for Clean Air (2001-2003) etc. Philippine Business for Environment, www.thepbe.org/ (last accessed 3 June 2015).

6. The Philippines ratified the Universal Declaration of Human Rights and International Covenant on Civil and Political Rights on 23 October 1986; acceded to the United Nations Convention Against Torture, on 18 June 1986; ratified the Convention on the Elimination of All Forms of Racial Discrimination on 15 September 1967; ratified the International Covenant on Economic, Social and Cultural Rights on 7 June 1974; ratified the United Nations Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families on 5 July 1995; ratified the Convention on the Elimination of All Forms of Discrimination Against Women, on 5 August 1981; ratified the Convention on the Rights of the Child on 21 August 1990; and ratified the Convention on the Rights of Persons with Disabilities on 15 April 2008.

7. Additional recommendations on how the Philippines should address the issue of extra-judicial killings have been developed by Human Rights Watch and are available here: www.hrw.org/ru/node/82034/section/13 www.hrw.org/ru/node/82034/section/13 (last accessed 18 April 2015).

8. The CARP was started in 1988 to redistribute lands to landless farmers and regular farmworkers, regardless of crops or fruits produced. While it is considered to have been fairly successful in redistributing land, the economic and social effects of the reform are mixed and the impact on poverty reduction considered by some to have been quite modest. For a more detailed discussion, see OECD (2017).

9. The National Land Use Act of the Philippines, Senate Bill No. 3091, was filed in 2011 but is currently still pending.

10. The OECD is currently developing *Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractives Sector* which could also provide helpful guidance on consultation with stakeholders affected by agricultural projects. The FAO-OECD *Guidance for Responsible Agricultural Supply Chains* also provides some guidance on stakeholder engagement in line with OECD *Due Diligence Guidance*.

11. Mineral resources include copper, gold, nickel, chromite, limestone, clays, feldspar and semi-precious stones (Raymundo, 2014).

12. Tripartite Industrial Peace Council, Philippines Bureau of Labor Relations. www.blr.dole.gov.ph/2014-12-12-03-27-59/2014-12-27-07-24-17/about-tipc (last accessed 26 April 2015).

13. See World Bank Data, http://data.worldbank.org/indicator/SL.AGR.EMPL.ZS(accessed 20 September 2015).

14. Republic Act 3931 of 18 June 1964. Retrieved from www.lawphil.net/statutes/repacts/ra1964/ra_3931_1964.html

15. This decree was amended to limit the EIS obligation to environmentally critical projects (Presidential Decree No. 1586, 1987).

16. On 13 April 2010, the Supreme Court approved the Rules of Procedure for Environmental Cases as a significant catalyst for sweeping and far-reaching reforms in environmental litigation and protection (Human Rights Council, 2012).

17. Including the Convention on Long-Range Transboundary Air Pollution (1999); Vienna Convention for the Protection of the Ozone Layer (1985), Montreal Protocol on Substances that Deplete the Ozone Layer (1987); Basel Convention (ratified, 1993).

18. The Philippine Greenhouse Gas Accounting and Reporting Program was launched in 2006 to assist businesses in the Philippines in preparing GHG inventories, identify GHG reduction opportunities, and participate in programmes and projects to reduce GHG emissions. Philippines,

Greenhouse Gas Protocol, www.ghgprotocol.org/programs-and-registries/philippines-program (accessed 25 April 2015).

19. The 2015 national budget has allotted PhP 14 bn for the Calamity Fund or the National Disaster Risk Reduction and Management Fund and PhP 6.7 bn for the Quick Response Funds. The administration's "Build Back Better" program designed to address the recovery requirements in the aftermath of Super Typhoon Yolanda and other previous calamities was allotted PhP 21.7 bn for 2015 to develop better and more resilient infrastructure that will enable the affected regions to weather future calamities. (GOVPH, 2014).

20. Environmental problems in the Philippines, World Wildlife Fund http://wwf.panda.org/who_we_are/wwf_offices/philippines/environmental_problems__in_philippines/ (last accessed 25 April 2015).

21. About one in four business executives surveyed in 2013 reported they had been asked for a bribe when obtaining national and local government permits or licences. Corruption Levels in the Philippines, Business Anti-corruption Portal. www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/philippines/public-services.aspx (last accessed 20 September 2015).

22. Corruption Perceptions Index 2014, Transparency International, .https://www.transparency.org/cpi2014/results (last accessed 25 April 2015).

23. See generally http://data.gov.ph/catalogue/dataset (last accessed 25 April 2015).

24. The Local Government Code of 1991 gave LGUs a leading role in environment and natural resources management. LGUs are tasked with regulation of a) environmental impacts of SMEs; b) fishing in municipal waters; c) minor mineral extraction like small-scale mining and certain scales of quarrying and sand and gravel gathering; d) nuisance and pollution under the Clean Air Act; e) solid waste management under the Ecological Solid Waste Management Act; and f) antismoke belching program (NEDA, 2011).

25. The Chapter on Competitive Industry and Service sectors only highlights CSR as a thematic area to be adopted in the SME development plan, but does not otherwise mention it. Likewise the chapter on Social Development discusses strengthening public-private partnership but does not highlight the role of the private sector in contributing to social development through core operations. The chapter on Conservation, Protection & Rehabilitation of the Environment & Natural Resources minimally discusses the roles and responsibility of the private sector.

26. See EU GSP PLUS, Department of Trade and Industry of the Philippines www.dti.gov.ph/dti/index.php/resources/export-essentials/eu-gsp-plus (last accessed 3 June 2014).

27. ASEAN CSR Network, Mission and Objectives www.asean-csr-network.org/c/about-us/our-mission-a-objectives (last accessed 25 April 2015).

28. Only 56 Philippine companies are currently involved in the initiative (Knudsen, 2011).

29. A UN ESCAP study of high performing Asian firms with regard to sustainability revealed that there was low uptake of the ISO 26000 standards and low involvement with UNGC amongst the companies analysed. This finding corresponded with the practices of companies based in the Philippines although the sample size of Philippine companies examined was too small to be meaningful. Only 3 companies out of the 167 analysed were Philippine. Out of these all there were involved with GRI, 2 with UNGC and none reported use of ISO 26000 (UNESCAP, 2013).

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