The National Business Systems of the Philippines

A strengthening alternative for outsourcing and investment
Executive Summary

The country of the Philippines has recently received much attention as an emerging outsourcing alternative to countries such as Ireland and India. As American companies increasingly look for ways to cut costs and eliminate overhead, outsourcing to countries with low labor wages, strong educational systems, and language compatibility has become a solution. While India has received the most attention because of its low labor cost, English-speaking population, and strong science and engineering education, the Philippines has been investing in developing these same strengths. The country still lags India in the strength of its science education and labor cost, but has a clear advantage when it comes to language-compatibility, incentives for foreign investors, and labor supply. It appears to be a great time to begin exploring and investing the Philippines as it completes its transformation and before competition gets as intense as has been seen in India.
Country Overview

The Philippines is a dynamic country that has changed dramatically over the past several centuries. After years of rule by other countries – including Spain, Japan, and the US – they became an autonomous country in 1946. Under a new constitution in February of 1987, the Philippines is a democratic republic with a bicameral legislature and an independent judiciary. Although the country’s GDP is growing (4.4% in 2002 versus 3.0% in 2001) due to strong private domestic consumption, the high population growth is dampening the GDP growth, causing high unemployment rates and low per capita GDP. Inflation rates have remained low, 3.1% in 2002 versus 6.1% in 2001; however, this has not helped improve unemployment which has remained over 10% since the mid-1990s. In 2003, the foreign debt had risen to $52B, while exports fell over 15.6%, creating a very difficult international position for the Philippines. The anticipation of the presidential election scheduled for May 10, 2004 is high, as the country is facing a depreciation Peso, a tough international economic position, as well as dealing with revolutionary forces prevalent in the South of the country that deter foreign investment.
National Business Systems

Human Capital Development

The people of the Philippines are improving their educational and human resources; however, they still have a 2003 Human Development Index of 0.754 (A ranking of the citizens quality of life based on the GDP index, life expectancy index, and educational index), which ranks them 73 out of 173 countries measured. Education is viewed as a way to escape by most Filipino, and parents push their children to excel in school. Education consists of 6 years of elementary and 4 years of high school. Afterwards, a seated exam is required before attending a higher education program. Business education is promoted extensively throughout the Philippines, and they have the highest numbers of MBA’s in the world.

Currently the public expenditure on education is 4.2% of GDP resulting in a net primary enrolment ratio for all school-age children of 93%. Advanced schooling, particularly with IT development, has become a major trend throughout the Philippines. The International Technology Association of the Philippines (ITAP) has recently received a grant of $30,000 from the US to survey the existing and anticipated IT in the Philippines against the existing worldwide IT requirements. The hope is to align the curriculum in schools around the IT needs, to meet the demands of the IT industry, and gain membership into the World Information Technology & Services Alliance (WITSA).

Corporate Governance

Businesses in the Philippines are based on the Philippines Corporate Code and Securities and Exchange Commission (SEC) modeled after the US. All publicly traded businesses have to be registered with the SEC, and the books of these companies are open to the public. At the annual general shareholders meeting (AGSM), each shareholder enjoys the one-share-one-vote rule. The Board of Directors approves all management decisions by majority vote, and all strategic decisions by 2/3 vote. Although the stock market seems open to the public, a majority of publicly traded Philippine
companies are owned by an average of 5 large shareholders who control the majority of the company, so these companies are not truly public\(^4\). Minority shareholders have limited power, which requires them to gain the favor of a majority holder in order to be heard at the AGSM. These large, family-based shareholders often form an ownership group that creates a diversified business portfolio, often working with each other and using family relationships to keep the group together. Similar to Japanese Keiretsu’s, these ownership groups often have minority ownership in banks to have a supply of external financing, as well as in affiliated companies to enjoy the benefits for the group. Outside directors are not mandatory for Philippines corporations and are not common. The strong family ties among shareholders typically leads to a board dominated by family members with little independent representation, if any\(^5\).

Foreign investment into the Philippines is allowed, however specific regulations have to be followed. Any foreign company must register with the SEC and be approved to operate within the Philippines. Although 100% foreign ownership is allowed, foreign direct investment (FDI) isn’t allowed in several industries that are considered critical for the Philippines\(^5\). The Philippines government is coming to witness the benefits of FDI; realized trade in 2003 was $18 billion with the United States alone\(^7\). Foreign firms can realize several benefits by investing in the Philippines.

With the liberalization of the foreign investments law, 100% foreign equity may be allowed in all areas of investment except financial institutions and those included in the fourth regular Foreign Investment Negative List which (see Exhibit B) took effect on October 24, 2000. This list includes: areas reserved to Filipinos by mandate of the Constitution and special laws such as but not limited to: mass media except recording, practice of licensed profession, retail trade, cooperative and small scale mining, etc. where foreign ownership is prohibited; advertising, ownership of land, operation and management of public utilities, etc. where only minority foreign ownership is allowed. areas that are defense related, those with adverse effects on public health and morals and domestic market enterprises with paid-in capital of less than US$200,000, unless they involve advanced technology or directly employ at least 50 employees, in which case, the paid-in capital can be US$100,000 only.
**Government Incentives**

**BOI Incentives**

The Board of Investments, through the 1987 Omnibus Investments Code, offers the following incentives to eligible enterprises:

1) Income tax holiday (ITH) for six years for pioneer firms and generally four years for non-pioneer firms. If a non-pioneer firm is located in a less developed area, it shall generally be entitled to 6 years ITH. Firms locating within Metro Manila shall not be granted ITH unless they are:

- within a government industrial estate
- service-type projects with no manufacturing facilities
- power generating plants
- exporters with expansion projects

2) Tax credit on raw materials, supplies, and semi-manufactured products.

3) Additional deduction from taxable income for labor expense (cannot be simultaneously enjoyed with the ITH incentive).

4) Additional deduction from taxable income for necessary and major infrastructure works (cannot be simultaneously enjoyed with the ITH incentives).

**PEZA Incentives**

The Special Economic Zone Act of 1995 empowers PEZA to manage and develop Special Economic Zones or Ecozones. Businesses operating within an ecozone are entitled to additional incentives. Exporters registered with PEZA enjoy tax and duty exemption on imports of capital equipment, raw materials, and other merchandise. Incentives are also provided to exporters for the use
of local materials. PEZA grants similar incentives to Information Technology (IT) companies that are registered in an IT ecozone, of which there are three IT parks and one IT building.

**Other Incentives**

Additional special economic zones were created under the sites of former US Military installations at Subic Bay, Clark Field, and Wallace Air Station. Enterprises operating in these zones avoid paying all other taxes except a final tax of 5% of gross income provided their income from local (non-export) sales does not exceed 30% of their income. To be eligible for the BOI/PEZA, foreign firms must complete an application process and have a majority of the directors be residents of the Philippines.

**Labor Relations**

The labor force in the Philippines is strong for both domestic and foreign companies. Laborers are highly trainable, often English speaking, and well suited for manufacturing operations. Independent surveys have shown that the Philippines rank fourth among Asian nations in terms of labor quality and first worldwide in competency in knowledge-based jobs. The country compares very favorable against its Asian neighbors on political risk, infrastructure, salary costs, and cultural compatibility to the US (see Exhibit C) and it also ranks favorably on infrastructure, accent and labor quality against both India and Ireland, two countries receiving much outsourcing attention (see Exhibit D). When comparing strictly cost and quality, the Philippines is second only to India (see Exhibit E), although there is evidence that India’s cost is increasing.

The Constitution and 1996 labor code allows all private and public sector citizens to freely form and join unions. The Philippine people are well organized within unions, and in 2001, approximately 3.6M individuals (11%) of the private sector workers were organized. Unions have not establish themselves with PEZA’s, because administrators often inhibit the development of unions by providing benefits and rights to the trained workforce to prevent the call for unionization.
Other general labor rules in the Philippines include the outlaw of child labor by the Constitution; however, these laws are seldom enforced. By law, women have the same labor rights as men; yet women are often paid 47% less and have a higher unemployment rate\(^1\). Finally, the government has enacted laws that set a minimum wage, the maximum number of hours worked, and Occupational Health and Safety requirements for the workplace\(^8\).

**Technology Policy**

Technology policy and investment has been a priority for the Philippines government. Known as a gateway to the Asian market, the Philippines is hoping to use its geographic position to lure foreign investment to develop its technological capabilities. In 1998, the Philippines adopted a new IP law to reflect the requirements of the WTO agreement on Trade Related aspects of Intellectual Property Rights (TRIPS). Priorities for development have included telecom facilities for high-speed productivity at low cost, promotion of software development, and the expansion of internet and cable services. Recently the government has worked to create the Department of Telecommunication and Information Technology to address internet privacy and security concerns for businesses and consumers. Another government agency developing technology in the Philippines is the Department of Science and Technology (DOST), which provides the country with central direction, leadership and coordination of all science and technology activities, as well as providing programs and projects to support national development priorities\(^8\). Several councils operating under DOST work to define policies, programs, and plans for specific Philippine industries including aquamarine, agriculture and forestry, advanced science, health, and industry and energy. Although DOST distributed $9.2M in funding in 2003, they have been accused by the media of being a complex and bloated system, which results in a weak development system to get technology systems commercially adopted\(^10\). Furthermore, the entire R&D process within the Philippines is poor, as they rank 78 out of 91 countries for the number of engineers and scientists per million people\(^10\). Because of low private sector R&D, and little government incentive to push R&D, the Philippines needs to invest more in their R&D development to keep up with the innovation pace of other Asian countries.
The Intellectual Property Office (IPO) of the Philippines protects the development of new technology, while facilitating the transfer of new technology and attracting foreign investment by protecting IP rights. This office approved the Patent Cooperation Treaty (PCT) and accepts international patent applications. They are also party to the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Budapest Treaty on the International Recognition of the Deposit of Microorganisms, the Patent Cooperation Treaty, and the Rome Convention. The patent office uses a First-to-File patent system, a protection term of 20 years, and allows multiple claims per patent. All patents are published 18 months after filing, with public comments allowed afterwards. Once published, the patent applicant must request a substantive examination within 6 months, after which the patent must be granted or refused based on the examiners findings. In 2001, the patent office received 2807 foreign and 946 domestic patent applications, and granted 1328 foreign and 351 domestic patents.

When it comes to fair competition, the government's words and actions differ a great deal. The Constitution states that “The State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed.” However, the government does not back up this statement with appropriate laws or enforcement. Collusion among industries is common. There have been very few cases involving price manipulation and deceptive sales practices, which are regulated through the Consumer Act and the Price Act.

Trade Policy

Trade policy reforms enacted by the Philippine government have resulted in a more open, competitive economy that was able to withstand the recent Asian financial crisis. The Constitution regulates monopolies and prohibits business combinations that restrain trade or promote unfair competition. The current export market of the Philippines is led by electronics, automotive products, and garments, which account for more than 70% of the total exports, and a current account surplus of $408M. The main trading partners with the Philippines are the US, which receives 35% of exports,
Japan receives 16%, and the European Union receives 16\%\textsuperscript{12}. Unfortunately, this situation has made the Philippines too reliant on the US, with hopes for a recovery in 2004 pinned on US growth\textsuperscript{13}.

Import growth has resulted from the reduction of tariffs by 50% over the past 6 years, the removal of non-tariff barriers, and elimination of quantitative restrictions\textsuperscript{14}. Imported manufactured items that do not compete with locally produced products face low tariffs, while imports that compete with local products can face tariffs up to 30 percent\textsuperscript{11}. Export growth is being led by the privatization of industries as well as the easing of investment policy, which is allowing for larger foreign direct investment. PEZA’s are an example of the government promoting business, which lead to an increase in the overall exports of the Philippines. All products, including imports, are subject to a 10% Value Added Tax (VAT)\textsuperscript{11}.

The Philippines are also active members in several trading organizations designed to create economic growth and technology acquisition, specifically to generate growth in the targeted areas. They have worked hard to align their trade policy with internationally standards, and over half of the current trade standards meet WTO rules. These targeted trade areas include Industrial Tree Plantation, Iron and Steel, exploration and mining/processing of minerals, publication/printing of textbooks, petroleum products refining/storage/distribution. On top of these internal projects, export growth is desired in agricultural, fishing and forestry industries, automotive products, energy/power generation and overall infrastructure improvements\textsuperscript{6}. As part of these goals and the goals of the Economic Mid-Range Plan the Philippines are members of the following trade agreements and organizations:

- Asia Pacific Economic Cooperation - simpler business travel with multiple entry visas, internet visa information and visa-free short-term entry through the APEC Business Travel Card; lower cost of trade in electrical goods such as computers, toasters, televisions, radios and power-tools through a single test for conformity assessments; internet access to information on tariffs, investment, e-commerce, intellectual property, business travel, government procurement, business opportunities through the BizAPEC.com website.

- ASEAN Free Trade Agreement - a six-year action plan, called the Hanoi Plan of Action or HPA, was drawn up and adopted by the ASEAN Heads of States and Government in Hanoi. It lays down specific steps and measures to be taken during the years 1999-2004 in order to strengthen macroeconomic and financial cooperation, advance economic integration and promote social, science & technology and information technology infrastructure as well as human resources development.
Industrial Policy

The Philippines is moving away from state-owned enterprises, privatizing them in order to create economic competition. This move away from state-run industry also creates challenges of freer markets. With deregulation and globalization, there will be an increase of both domestic and imported competitors, and the Philippines must focus on its competitive advantages. Because tariffs have allowed some industries to avoid foreign competition, they may be unprepared to compete in the global marketplace.

The Philippine government has enacted a number of policies to encourage labor-intensive and export-oriented industries to develop and grow. Recently, information and communication technology (ICT) and tourism have received the most attention. The focus on ICT is consistent with the desire for fast growing industries and high-value jobs. The Philippines believes that it is one of the major world centers for software development and data management in this decade. However, to continue growth in these areas, the country must invest in the appropriate laws, infrastructure, and education to support this growth. The Philippine Congress is still working to address Internet privacy and security laws. The country also lacks a robust and complete phone system and electrical infrastructure. Finally, while the education system is strong and vibrant, it produces far fewer science and engineering graduates than other Asian countries.

Too many independent government agencies watch business, resulting in the Philippine government’s inability to promoting a robust, competitive market. Because of several agencies watching the same industries, it results in a lack of focus, coordination, and accountability. Therefore,
laws that are created by one agency can be negated by the next, which reduces the potential of a freer market. The Philippines needs to review the agencies it has created, to streamline the governments focus and overview of businesses.
Recent Developments

There is a great deal of attention being paid to the Philippine presidential election to be held in May. The incumbent Gloria Arroyo is running against Fernando Poe Jr., a movie actor with no political experience and no high school diploma. Surprisingly, the polls show an incredibly close race. A side effect of the upcoming election is an incredible spending by the Philippine government. Arroyo and numerous government agencies are approving widespread spending in an attempt to win over voters with short-term improvements. Arroyo’s campaign seems to be moving with full force, even undertaking a number of activities that are illegal, but have gone unchallenged by the Comelec, the election commission19. Both of these candidates plan to name other actors and sports personalities to public office, including Congress. There is fear that these appointments will make the government even less representative of the Filipino people.

Lagging Philippines R&D efforts recently received a shot in the arm in the form of P9.2 million earmarked for R&D in the fields of science and technology20. The money, from the Philippine Council for Advanced Science and Technology Research and Development, will be targeted at projects in space, biotechnology, information and communications, photonics, and materials science.

When the Philippines originally copied India’s actions to attract foreign – and specifically US – outsourcing of IT, software development, and call center services, the Philippines were at a disadvantage compared to India’s strong R&D, infrastructure, and science education initiatives. However, India’s success is benefiting the Philippines in at least ways. Obviously, India has broken the ice and illustrated how US corporations can benefit from outsourcing to Asia, and this has opened up the market for the Philippines. Additionally, India’s success is causing an increase in pay rates18. The double-digit growth in salaries, a result of supply and demand, along with the realization that efficiency gains of only 10-20% are realistic, is likely to decrease the outflow of jobs to India. This provides an opportunity for Filipinos to step in at a lower price point and steal a larger piece of the market.

Because of its recent success is wooing US companies to outsource to the Philippines, the Philippines must now deal with a US backlash. Presidential candidate John Kerry is campaigning on a
platform that promises to stem the flow of jobs overseas, Congress is considering a number of laws aimed at protecting US jobs, and 20 states have pending legislation that would ban the use of offshore contractors. India has begun a campaign to educate the American people on the benefits of outsourcing and the advantage of using Indian workers. If the Philippines does not undertake a similar campaign, it may lose a substantial amount of potential revenue.

The aggressive move toward service-based businesses from agribusiness is almost too successful in the Philippines. Data recently released by the National Statistics Office indicates that the number of farmers, fishers and forestry workers decreased by 6.2% over the last year\(^1\). During this same period there was an increase in service workers and shop and market sales workers as well as laborers and unskilled workers. The share of rural workers also decreased. All this occurred at a time when the total number of jobs in the country increased by 4.7%. The government has realized that a wholesale shift from agribusiness to service business is not in the countries best interests, and they have approved P30 million to implement the Young Farmers Program which aims to promote continued investment in agribusiness and encourage the next generation to develop businesses that leverage the farming and fishing resources of the Philippines.

Citing fiscal problems and the "unsettled political dynamics" ahead of the May 10 presidential election, Moody's Investors Service cut Philippines' long-term bonds and notes to Ba2, two levels below investment grade, from Ba1 in January 2004. The outlook on the rating is negative, suggesting it may be lowered further. The above fiscal problems include budget deficit and huge nation's debt. The budget deficit widened in the first quarter in 2004 as slowing economic growth slashed tax revenue, analysts said. The shortfall may increase further as the government boosts spending to win votes in May's election. To make matters worse, the rating cut by Moody's may increase borrowing costs for the Philippines, which has earmarked a third of this year's budget to pay interest.
Analysis of the Philippines

Competing in the Philippines

The Philippines offers a number of attractive reasons to operate a business inside its borders. However, there are an equal number of pitfalls that foreign organizations must navigate. First, the population is highly educated, highly trainable, and fluent in English. This makes outsourcing attractive, especially in areas such as call centers and customer service. The large number of MBAs provides ample management talent as well. However, there is an incredible low number of science and engineering graduates, limiting the market for IT, software, and engineering design. Second, is the cost advantage of having an outsource facility located in the Philippines (see Exhibits D, E, and F). There is no question that an outsourcing center in the Philippines has significant cost advantages over the US as well as against countries that offer similar services. Third, not only is the labor pool highly educated and fluent in English, but the labor pool itself is extremely large. Fourth is the fact that the Philippines has a very foreign investor friendly environment. The Philippines are widely recognized as one of the most Westernized countries in that region, making trade with Western nations far easier. Fifth, and related to this is the cultural affinity. Being so Westernized, the Philippines have a culture that is easy for both Western business people to adjust to as well as business customs that are very similar to doing business in any Western culture. Finally is the focus on education. The workforce is highly educated because the government has focused on literacy, training programs, and developing an educational focus and infrastructure that leads in the area.

There are certainly risks associated with outsourcing in the Philippines. One being that while this is an advanced nation, the infrastructure in general is spotty and very regionalized. From transit to electricity to hi speed internet access varies according to region. Another risk is the maturity of the outsourcing market. While the Philippine government has put emphasis on this area, it is still a relatively new line of business. As a result the processes of how to run and operate an outsourcing center are not mature and there will have to be a learning curve involved in starting an enterprise here not only for the staff on-site, but also for the company that is investing in a center here for the first time.
Foreign investment is encouraged by the government and foreign ownership is allowed in most industries. Foreign investors enjoy tax holidays and tax credits, and ecozones offer the promise of additional incentives. However, these outside firms are at a disadvantage when it comes to the strong family ties that domestic businesses enjoy. In addition, while the country does have fair trade laws, they are weak and violators are seldom prosecuted.

The Philippines is investing heavily in IT infrastructure. But they are still lagging behind in the protection of intellectual property. Compared to other Asian countries, R&D investments are far behind.

Foreign companies that require imported materials to produce goods must deal with import tariffs. The tariffs are especially high if the goods are also available within the country. These tariffs are designed to protect Philippine businesses in internal markets, but could potentially limit the growth of the overall market by limiting the incentive for business to move into this new arena.

The Philippines is still in a major stage of development, and there is a ways to go before it reaches maturity. However, the pace of growth requires that foreign companies pay attention. Given the long list of pros and cons, companies considering entering the Philippine market must choose the appropriate industry and must divide the domestic and imported segments of the business carefully.

**Philippines Competing Abroad**

The Philippines was hit hard by the 1997 Asian crisis, which affected trades relationships with their largest partners like Japan and Taiwan. Without the influence of these major markets, the Philippines has allowed spending on domestic projects to fall, which is limiting their international growth potential. Without investments in such areas as domestic infrastructure, communication, and transportation, domestic companies will have adverse costs that affect their position to compete.

Another issue is tariffs, which have protected domestic companies from global competition and reduced their drive to improve efficiency. Philippine companies will quickly learn that global competitors have a better financial position in which to compete because they have not been protected by domestic tariffs, and have found other ways to drive efficiency and productivity within their organizations. Another major
A major benefit for the Philippines competing abroad is the location of the country in respect to its worldwide trading partners. Located at the edge of southeast Asia, the Philippines is very well geographically positioned to supply to all major markets including the US, Japan, China, and the surrounding southeast Asian countries. This geographic location alone puts the Philippines in a great economic position to compete internationally. As previously mentioned, the strong workforce within the Philippines will help them compete internationally. Because the workforce is very trainable, the inefficiencies that have resulted due to protective tariffs can be reduced by using the potential of the workforce. Finally, the close relationship that the Philippines shares with its major trading partners, both economically and culturally, will help them compete. As businesses move to increase their exports, they have a strong relationship already in place that they will be able to use to increase their global business. With these strong domestic resources, the Philippine companies have several strategic advantages that will help them compete in the international markets.
Macroeconomic Analysis

Economic Conditions

Strengths

Philippines economy has shown strength recently for the following reasons;

- **Resilient Growth**: Its GDP growth rate increased to 4.4% in 2002 from 3.0% in 2001, registering its strongest performance since the 1997 Asian financial crisis, despite an adverse external environment and continued threats to local peace and order (Figure 1).

![Gross Domestic Product Growth](image)

In 2002, growth accelerated, but remains lower than pre-crisis levels.

**Figure 1**: GDP of the Philippines from 1994 through 2004.

- **Low inflation**: The inflation rate (consumer price index) fell to 3.1% in 2002 from 6.1% in 2001 due to lower prices across commodity groups—food, services, housing, and energy-related products (Figure 2).
Figure 2: Interest rates and inflation rates for the Philippines from 1998 through 2002.

- **Strong private consumption growth:** On the demand side, personal consumption was strongly supported by spending on household products, transport and communication services and contributed almost 60% of GDP growth in 2002. In other words, it is domestic-led growth.

- **Recovery in exports; healthy international reserves:** After a contraction of 16.2% in 2001, merchandise exports rose by 10.1% in 2002, boosted by recovery in the global demand for electronics. Semiconductors and garments are the top contributors to the growth of merchandise exports. Imports grew by 6.2% in 2002, compared with a 4.5% contraction in 2001. With imports growing slower than exports, the trade balance registered a surplus of $408 million in 2002 compared with a deficit of $743 million in 2001.

- **Growing remittances from overseas workers:** The significance of “Overseas Filipino Workers” (OFW) is increasing because job opportunities are not efficient in Philippines. Their earnings back home make a significant contribution to the economy as a source of obtaining foreign currencies.
Vulnerabilities

On the other hand, the Philippines economy is vulnerable in some areas. One of the factors is high population growth, dampening the impact of economic growth.

- **High unemployment**: Employment has by and large grown more slowly than the labor force. Consequently, the unemployment rate has been over 11% since the mid-1990s (higher than the trends observed in other ASEAN countries), and is more pronounced among women than men. Feasible solutions to create job opportunities are (i) attracting foreign companies’ investment, (ii) encouragement of migrant working abroad and (iii) expansion and diversification in agriculture and industry (the service sector is already absorbing 47% of the workforce). Especially low productivity in agriculture needs to be improved (though it absorbs 37% of workforce it contributes only 14% of GDP\(^2\) (Table 1).

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<thead>
<tr>
<th>Structure in 2002</th>
<th>% of Labor Force</th>
<th>% of GDP</th>
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<tr>
<td>Agriculture</td>
<td>37.4</td>
<td>14.7</td>
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<tr>
<td>Industry</td>
<td>15.4</td>
<td>32.5</td>
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<tr>
<td>Services</td>
<td>47.2</td>
<td>52.8</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
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Table 1: Labor force analysis and industry analysis versus total GDP for the Philippines.

- **Low Per Capita GDP**: Per capita GDP of Philippines is relatively low ($969 in 2002). It ranks fourth out of five Southeast Asian countries in 2002 (Indonesia is next to Philippines).
Another factor providing a negative impact on Philippines economy is its fragile fiscal position.

- **External debt rising**: The rise in key external debt indicators (debt-GNP ratio and debt service ratio) necessitates careful monitoring, although the maturity and currency mix of external debt appears reasonable (Figure 3). After the Asian currency crisis, foreign debt increased remarkably and it is now risk factor in this country. The increase in 2002 of total outstanding external debt resulted essentially from foreign exchange revaluation adjustments on non-dollar-denominated debt, and also from government borrowings.

![External Debt Graph]

A favorable debt profile has cushioned the impact of the rising debt stock.

**Figure 3: Total debt as a percentage of the GNP and total debt service**

- **Interest payments preempting a growing share of the budget**

- **Low tax-GNP ratio**: Due largely to continued weaknesses in tax administration, tax collections declined from 16.3% of GNP in 1997 to only 11.6% in 2002. Besides these trends, the shortfall in tax revenues in 2002 was also due to the fall in revenues from interest incomes as interest rates fell, concentration of growth in lightly taxed agriculture and export sectors, and lower collections from import duties. The Bureau of Internal Revenue (BIR) is strengthening tax collections by tightening tax administration and pursuing taxpayers through
reminders for the tax payment, expanding the electronic filing and payment system for taxes, setting up a payment warning system for taxpayers, and sanctioning firms at the expiration of the 5-day VAT compliance period. These enhancements helped improve revenue collections in the last quarter of 2002, but it could not compensate for the revenue shortfalls in the preceding three quarters of 2002.

- **Low and declining discretionary expenditure**: The public expenditure-GNP ratio stagnated at 18-19% during 1997-2002. Current expenditures declined slightly in 2002 as a proportion of GNP, mainly due to the tight revenue situation. The difference between revenues and mandatory expenditure obligations (wages, interest, and other transfers) decreased from 3.3% of GNP in 1998 to almost none in 2002, leaving an ever-smaller share for discretionary spending. The sharpest cut in discretionary spending was in the maintenance and operating expenses. The high fiscal deficits have forced the Government to borrow more, and the interest payment obligations rose from 16.6% of total expenditures in 1997 to 23.9% in 2002. In 2002, capital outlays increased slightly as a percentage of GNP, largely because of the increase in investment funding.

![The steady erosion of tax effort is reflected in rising deficits, rising interest payments, and declining discretionary expenditures.](image)

**Figure 4**: Fiscal performance of the Philippines: Deficit/GNP (%), Interest payments/Total Expenditures (%), Tax/GNP (%), and Expenditures/Total Expenditures (%).
Investment climate uncertainties are also a negative factor.

- **Investment climate uncertainties:** The investment-GNP ratio in 2002 remained low at only three quarters its level in 1997 (18.1\% in 2002 vs 23.8\% in 1997). The investment climate in the Philippines is adversely affected by complicated investment procedures, high transaction costs, infrastructure constraints, and growing competition for foreign direct investment (FDI).

**Government Economic Development Plan**

The current administration’s medium-term policy – targeted toward the goal of reducing poverty – is outlined in the Medium-Term Philippine Development Plan. This plan is highlighted by four areas of focus:\(^27\):

1) Macroeconomic stability and equitable, accelerated, and broad-based growth, based on free enterprise

2) Socially equitable modernization of agriculture and fisheries to achieve sustainable increases in rural-incomes and to include improved access to land tenure, extension services, rural infrastructure, and credit

3) Comprehensive human development, addressing quality and access to education, health and housing services, protecting the vulnerable, and addressing regional disparities and the particular challenges of Mindanao

4) Good governance and rule of law, including improved service delivery, institutional strengthening, and judicial reform.
BIBLIOGRAPHY


9) “The Department of Science and Technology (DOST)”. 2002 <http://www.dost.gov.ph>


Exhibits
Exhibit B: Limitations on Foreign Ownership by Industry and the "Negative List" of industries where investment is not allowed

List A: FOREIGN OWNERSHIP IS LIMITED BY MANDATE OF THE CONSTITUTION AND SPECIFIC LAWS

No Foreign Equity

1) Mass media, except recording (Article XVI, Section II of the Constitution; Presidential Memorandum dated May 4, 1994)

2) Services involving the practice of licensed professions save in cases prescribed by law. [Article XIV Section 14 of the Constitution; Section 1 of Republic Act (RA) 5181]

3) Retail trade enterprises with paid-up capital of less than US$2.5 million (Sec. 5 of RA 8762)(a)

4) Cooperatives (Chapter III, Article 26 of RA 6938)

5) Private security agencies (Section 4 of RA 5487)

6) Small-scale mining (Section 3 of RA 7076)

7) Utilization of marine resources in archipelagic waters, territorial and exclusive economic zone (Article XII, Section 2 of the Constitution)

8) Ownership, operation and management of cockpits [Section 5 of Presidential Decree (PD) 449]

9) Manufacture, repair, stockpiling and/or distribution of nuclear weapons. (Article II, Section 8 of the Constitution)(b)
10) Manufacture, repair, stockpiling and/or distribution of biological, chemical and radiological weapons (Various treaties to which the Philippines is a signatory and conventions supported by the Philippines)(b)

11) Manufacture of firecrackers and other pyrotechnic devices (Section 5 of RA 7183)

Notes:

(a) RA 1180 as amended by RA No. 8762; see pages 32 & 33 on Retail Trade for the update.

(b) For items 9 and 10, domestic investments are also prohibited(Article II, Section 8 of the Constitution and conventions / treaties to which the Philippines is a signatory).

Up to Twenty-Five Percent Equity

12) Private recruitment, whether for local or overseas employment (Article 27 of PD 442)

13) Contracts for the construction and repair of locally funded public works (Commonwealth Act (CA) 541 as amended by PD 1594; Letter of Instruction No. 630) except:

(a) infrastructure/development projects covered in RA 7718 or the expanded BOT Law; and

(b) projects which are foreign funded or assisted and required to undergo international competitive bidding (Section 2a of RA 718).

Up to Thirty Percent Foreign Equity

14) Advertising (Article XVI, Section 11 of the Constitution)

Up to Forty Percent Foreign Equity

15) Exploration, development and utilization of natural resources Note: Full foreign participation is allowed through financial or technical assistance agreement with the President (Article XII, Section 2 of the Constitution)
16) Ownership of private lands (Article XII, Section 7 of the Constitution, Chapter 5, Section 22 of CA 141)

17) Operation and management of public utilities (Article XII, Section 11 of Constitution; Section 16 of CA 146)

18) Ownership/establishment and administration of educational institutions (Article XIV, Section 4 of the Constitution)

19) Culture, production, milling, processing, trading excepting retailing of rice and corn and the by-products thereof (Sec. 5 of PD 194; Sec. 15 of RA 8762)

20) Contracts for the supply of materials, goods and commodities to government-owned or controlled corporation, company, agency or municipal corporation (Section 1 of RA 5183)

21) Contracts for the construction of defense-related structures (Sec. 1 of CA 541)

22) Project proponent and facility operator of a BOT project requiring a public utilities franchise (Article XII, Section 11 of the Constitutions; Section 2a of RA 7718)

23) Operation of deep sea commercial fishing vessels (Section 27 of RA 8550)

24) Adjustment companies (Section 323 of PD 612 as amended by PD1814)

25) Ownership of condominium units where the common areas in the condominium project are co-owned by the owners of the separate units or owned by a corporation (Section 5 of RA 4726)

**Up to Sixty Percent Foreign Equity**

26) Financing companies regulated by the SEC (Section 6 of RA 5980, as amended by RA 8556)

27) Investment houses regulated by the SEC (PD 129 as amended by RA 8366)
28) Retail trade enterprises with a minimum paid-up capital of US$2.5 million, but less than US$7.5 million (Sec. 5 of RA 8762)

Notes: For items 26 and 27, no foreign national may be allowed to own stock in financing companies or investment houses unless the country of which he is a national accords the same reciprocal rights to Filipinos. For item 28, full participation shall be allowed after March 25, 2002, but in no case shall investments for establishing a store be less than US$830,000. Full foreign participation is currently allowed in the following categories: 1) Enterprises with a paid-up capital of US$7,500,000 or more, provided that investments for establishing a store should not be less than US$830,000; and 2) Enterprises specializing in high-end or luxury products, provided that the paid-up capital per store is not less than US$250,000 (Sec. 5 of RA 8762)

LIST B: FOREIGN OWNERSHIP IS LIMITED FOR REASONS OF SECURITY, DEFENSE, RISK TO HEALTH AND MORALS, AND PROTECTION OF SMALL- AND MEDIUM-SCALE ENTERPRISES

Up to Forty Percent Foreign Equity

1) Manufacture, repair, storage and/or distribution of products and ingredients used in the manufacture of firearms, gunpowder, dynamite, ingredients used in making explosives, telescopic sights and other similar devices requiring Philippine National Police clearance.(RA 7042, as amended by RA 8179)

2) Manufacture, repair, storage and/or distribution of products such as guns other ammunitions, military aircraft, vessels, equipment and training devices and parts and components thereof, requiring Department of National Defense (DND) clearance, and others as may be determined by the Secretary of the DND. (RA 7042, as amended by Republic Act 8179)

3) Manufacture and distribution of dangerous drugs (RA 7042, as amended by RA 8179)

4) Sauna and steam bathhouses, massage clinics and other like activities regulated by law because of risk they impose to public health and morals (RA 7042, as amended by RA 8179)
5) Other forms of gambling, e.g., race track operation (RA 7042, as amended by RA 8179)

6) Domestic market enterprises with paid-in equity capital of less than the equivalent of US$200,000 (RA 7042, as amended by RA 8179)

7) Domestic market enterprises which involve advanced technology or employ at least 50 direct employees, with paid-in-capital of less than the equivalent of US$100,000 (RA 7042, as amended by RA 8179)
Exhibit C: Philippines comparison with China, India, Malaysia, South Korea, Vietnam

<table>
<thead>
<tr>
<th>Country</th>
<th>Philippines</th>
<th>India</th>
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<tbody>
<tr>
<td>Status</td>
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<tr>
<td>Geopolitical risk</td>
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<td>High</td>
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<tr>
<td>Infrastructure</td>
<td>Good</td>
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<tr>
<td>Average Salary</td>
<td>$6,564/Year</td>
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<tr>
<td>Cultural Compatibility</td>
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<td>Fair</td>
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<tr>
<td>Areas of Expertise</td>
<td>Application development, application maintenance, call centers, business continuity and disaster recovery, e-business</td>
<td>Application development, application maintenance, packaged software, e-business</td>
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<table>
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<td>Status</td>
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<tr>
<td>Average Salary</td>
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<td>Cultural Compatibility</td>
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<td>Application development, application maintenance, call centers, business continuity and disaster recovery, e-business</td>
<td>Application development, application maintenance, e-business</td>
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<tr>
<td>Infrastructure</td>
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<tr>
<td>Average Salary</td>
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<td>Poor</td>
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<tr>
<td>Areas of Expertise</td>
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<td>Application development, application maintenance, e-business</td>
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<th>China</th>
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<tr>
<td>Status</td>
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<td>Geopolitical risk</td>
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<td>Areas of Expertise</td>
<td>Application development, application maintenance, call centers, business continuity and disaster recovery, e-business</td>
<td>Application development, application maintenance, QA testing systems integration</td>
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</table>

Exhibit D: Outsource Country Comparison

Phillipines | Ireland | India
---|---|---
Cost
Labor Quality
Telco Infrastructure
Accent
Country Risk
Competitive Analysis of Outsourcing Locations

Exhibit E: Labor Quality v. Cost

Source – NeoIT Global Offshore Advisors, www.NeoIT.com