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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