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STATEMENT OF THE JOINT FOREIGN CHAMBERS IN THE PHILIPPINES BEFORE THE SENATE TRADE COMMITTEE ON SENATE RESOLUTION 476 REVIEW OF THE RETAIL TRADE ACT (RA 8762)

October 4, 2011

HONORABLE
MANNY VILLAR
Chairman
Committee on Trade and Commerce
Philippine Senate
Pasay City

Dear Mr. Chairman:

Thank you for the opportunity to appear before the Senate Trade and Commerce Committee to express the position of the Joint Foreign Chambers on Senate Resolution 476 – Urging a Review of the Retail Trade Act (RA 8762).

It is particularly appropriate that you are chairing this hearing because the law we are discussing was passed almost 12 years ago in February 2000 when you were serving as Speaker of the House of Representatives.

In summary the Joint Foreign Chambers of Commerce do not believe that Act has achieved its objective of liberalizing foreign ownership in the retail trade sector due to various restrictions it imposes requiring 100% local ownership for most retail businesses with capitalization below USD 2.5 million and other conditions which deter many investors. We have found very few similar restrictions elsewhere in Asia, a situation that results in the Philippines being at a serious competitive disadvantage in seeking foreign investment for medium-sized businesses which should be the backbone of the Philippine economy and employment generation. To rectify this situation we recommend that the current legislation be amended to reduce the threshold at which foreign investment is allowed to the level of the Foreign Investments Act (Republic Act 7042, as amended by RA 8179) and otherwise to remove conditions not found in RA 7042, as amended. Our analysis and commentary on this situation with the current legislation is given in detail below.

Retail trade is one of the most important business sectors in the Philippine economy. Yet the retail sector remains one in which foreign investment is extremely low, because of historical protectionism of the sector and a very limited liberalization policy since 2000 in RA 8762, a law entitled "Liberalizing the Retail Trade Business," which the last decade has proven in practice to have imposed conditions that were anything but "liberal."

Accordingly, today's hearing - called for the purpose of reviewing whether the current policy is still in the best national interest - is highly appropriate to review whether the sector should remain protected or liberalized more in order to attract more foreign investment, create more jobs, and enhance consumer welfare.

Our statement will:

(1) briefly discuss the importance of the retail trade sector to the Philippine economy;
(2) take a brief look at the history of regulation of foreign participation in retail trade in the country;
(3) look at the restrictions in the present Retail Trade Act and discuss their impact;
(4) examine policies in other Asian economies governing foreign investment in retail trade;
(5) make recommendations for future legislation for the consideration of the Committee; and
(6) enumerate some of the benefits of a liberalized retail trade industry.

<u>Importance of Retail Trade in the Philippine Economy</u>

Retail trade is a vital, essential, dynamic and growing part of the Philippine economy. The retail trade sector in 2010 accounted for 13% of national GDP. Moreover, the sector is growing at a faster rate than GDP. According to a 2009 study by two professors at the University of Mindanao School of Management in Davao, the share of retail in the overall trade sector has steadily grown over the years to more than 75%. This study showed that from 1997 to 2007 the average annual growth of the sector exceeded 7%, while GDP grew at less than 5%. [1]

Aside from contributing a major share of national GDP, the wholesale/retail sector also contributes a high share of total employment, ranking behind the agriculture, fishery, and forestry sector. And employment in retail is growing; it increased from 15% of total employment in October 1997 to 19% in October 2006. In 2010, 7 million persons were employed in the wholesale and retail trade industry, 305,000 more than the previous year, and the retail trade sector accounted for 19.5% of total employment. Many of those working in the sector are in the informal sector, especially operators of *sari-sari* stores, which number over 500,000. In fact, the *sari-sari* store is as ubiquitous to the Filipino landscape as the jeepney, the tricycle, and the carabao.

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[1] The Changing Landscape of the Philippine Retail Food Industry, Glory Dee Romero and Larry N. Digal, 2009, University of the Philippines Mindanao
http://or.upmin.edu.ph/OJS/index.php/banwa/article/view/70/74

The number of individuals employed in the wholesale/retail sector indicates that a significant portion of the population depends on retailing for their main source of income. Many jobless and underemployed individuals engage in informal retail trade, since doing so requires minimum capital and skills. In fact, the high underemployment rate in the country has stimulated the growth of the informal sector and its increasing share in the labor force.[2] Many part-time workers, including some students, also engage in retail activities.

Also, many families in rural areas depend on retailing for additional income. Their farm produce is sold directly to consumers or indirectly in public markets. Retailing also shows the prevalence of the free enterprise system of Filipinos. This underscores a part of the Filipino way of life where individual entrepreneurs peddle goods in areas where the number of potential consumers is high. Further, remittances from overseas Filipino workers (OFWs) often are used as capital by their families to engage in retail activities.

Mr. Chairman, I think with these facts in mind, we can agree that the health and growth of the retail trade sector in the country is of great importance to the national well-being, as so many Filipinos engage in it, from the man selling bottled water in a traffic jam to the largest chain of malls in the country, several of which rank among the largest in the world.

Therefore, we posit that the issue before the Committee today concerns the future of retail trade in the Philippines and whether opening the retail trade sector more to foreign investors will benefit the Philippine economy, the Filipino workforce, and the Filipino consumer.

A Brief Look Backwards

If we step back for a moment, Mr. Chairman, the Philippines historically did not always limit retail trade to Philippine nationals. Informal foreign traders have settled in the Philippines for over a millennium and continue to do so today, in Divisoria, for example, and probably illegally in today's context. But historically, there were few if any restrictions, and Southern Chinese traded and settled in pre-Hispanic trading entrepôts such as Cebu, Manila, and Puerto Galera.

During the Spanish colonial period there were restrictions on foreign retail traders; Spanish authorities discouraged foreign merchants from residing and doing business domestically, despite their opening of the economy to foreign import-export merchants in the early 1800s.

The Americans were more liberal about retail trade, allowing various nationalities to participate. The American Chamber of Commerce itself was established in 1902 by several American entrepreneurs sitting around a table of narra

[2] National Anti-Poverty Commission (NAPC). 2002. Informal sector vendor in the workplace. NAPC, Manila, Philippines.

wood at an American restaurant called Clarke's in Escolta. Old photos of the Binondo commercial area show Spanish, Filipino, and American businesses operating - and competing - side-by-side.

Over a half century ago, the Philippine economy took a highly protectionist step when the retail sector was restricted to Philippine nationals. RA 1180 enacted on June 19, 1954 and signed by President Ramon Magsaysay stated:

> Section 1. No person who is not a citizen of the Philippines, and no association, partnership, or corporation the capital of which is not wholly owned by citizens of the Philippines, shall engage directly or indirectly in the retail business.

This law was intended to protect non-Chinese Filipinos from the retail ambitions of the immigrant Chinese Filipinos, quite a few of whom were moving into the Philippines after the communists came to power in 1949 on the Chinese mainland. This period – in the first decade of independence from American and Japanese colonial rule – was also the height of the import-substitution policy, in which local so-called "infant" industries were protected from imports and competition.

Despite the intent of the law to exclude non-Filipinos, in the 1960s and 1970s the Filipino-Chinese population acquired Filipino citizenship and became very strong in the retail trade sector.

Over the last decade, a new flow of Asians from Korea has moved to the Philippines. Authorities estimate as many as 200,000 now live and work in the country. Many are engaged in small businesses, often retail operations such as restaurants, specialty food stores, English language training schools, and businesses supporting Korean tourists, such as small hotels and water sports rental shops.

<u>Partial Liberalization: the Retail Trade Act of 2000 and Its Impact</u>

An apparently significant reform was introduced in RA 8762 in March 2000 under President Joseph Estrada, allowing limited entry of foreign investment in the retail sector. However, in the 11 years since passage of the law, real liberalization has not been achieved. According to BSP figures, from 2000 to 2009, foreign direct investment in the retail and wholesale sector combined was less than one percent of total FDI inflow.

We believe that the reforms made in RA 8762 have not resulted in substantial foreign investment in retail trade in the Philippines. According to information from the Department of Trade and Industry, only 12 foreign retail firms have invested in the country's retail sector since 2000. This is an average annual rate of one firm per year. Included are firms which invested in pre-existing retail operations in the country. Very few new jobs have been created in the last decade as a result of RA 8762.

Why has so little foreign investment entered the economy since 2000 in retail trade? While we are not aware of any surveys of foreign retail investors that would provide precise data on why they have not entered the Philippine market, we are convinced that an important reason is that the restrictions in the current law actually discourage rather than encourage foreign investment.

What are these requirements for a foreign entity to engage in retail trade or invest in a retail store in the Philippines as contained in RA 8762 and its IRR?

1. Documentary requirements. A request for pre-qualification duly signed and acknowledged under oath by an authorized officer of the foreign retailer must be submitted to the Board of Investments accompanied by the following documents:

a.) Latest audited annual financial statements incorporating an income statement and a balance sheet or their equivalents:

i. For Category B – minimum of US$200M net worth;
ii. For Category D – minimum of US$50M net worth.

b.) Certification by a responsible officer of the applicant-foreign retailer duly authenticated by the Philippine Embassy/Consulate stating that:

i. it has been engaged in retailing for the past five years;
ii. has at least five (5) retailing branches anywhere in the world, or at least one branch is capitalized at a minimum of US$25 million.

c.) Copies of franchise or licensing agreements between the applicant and its franchisee/licensee if the applicant fails to meet the preceding requirement of at least five (5) retailing branches; and

d.) Certification by the proper official of the home state of the applicant-foreign retailer to the effect that the laws of such state allows or permits reciprocal rights to the Philippine citizens and enterprises together with the extent of participation allowed.

2. Foreign equity requirements.

Category B – Enterprises with a minimum paid-up capital of US$2.5 million. (For the first two years the law was in effect foreign investment was restricted to 60% if the capital was less than US$7.5 million).

The opening of branches by a foreign retailer is allowed, provided that the investments of each store/branch established under Category B must be no less that the peso equivalent of $830,000.

Category D – Enterprises specializing in high-end or luxury products with a paid-up capital of US$250,000 per store may be wholly owned by foreigners.

3. Public offering of shares of stock.

All enterprises under Category B in which foreign ownership exceeds 80% of equity shall offer a minimum of 30% of their equity to the public through any stock exchange in the Philippines within eight years from their start of operations.

4. Local procurement.

For ten years after the effectivity of the Act, at least 30% of the aggregate cost of the stock inventory of foreign retailers falling under Categories B and C and ten percent (10%) for category D shall be made in the Philippines.

5. Other.

Qualified foreign retailers shall not be allowed to engage in certain retailing activities outside their accredited stores through the use of mobile or rolling stores or carts, the use of sales representatives, door-to-door selling, restaurants and *sari-sari* stores, and such other similar retailing activities.

The foreign investor shall be required to maintain in the Philippines the full amount of the prescribed minimum capital unless the foreign investor has notified the SEC and the DTI of its intention to repatriate its capital and cease operations in the Philippines. The actual use in Philippine operations of the inwardly remitted minimum capital requirement shall be monitored by the SEC.

Failure to maintain the full amount of the prescribed minimum capital prior to notification of the SEC and the DTI, shall subject the foreign investor to penalties or restrictions on any future trading/activities/business in the Philippines.

Foreign retail stores shall secure a certification from the BSP and the DTI, which will verify or confirm inward remittance of the minimum required capital investments.

These restrictions are onerous if the intention of the 2000 law was to attract substantial foreign capital into the country's retail sector. As we will see they are quite unique in Asia when compared to other countries that have truly liberalized their retail sectors.

The inability to own land (under the Constitutional restriction) is also a deterrent to some potential foreign investors. Foreign retailers who are interested in investing in the country must look for local partners with land equity or access.

Joint venture alliances with domestic entities are preferred by some foreign retailers, since local players are more familiar with the local environment and conditions. Examples of such arrangement include SM with Watsons and McDonald's. Price-Costco entered the market with plans for ten stores but eventually sold out to its local partner following serious business disagreements.

The capital requirement is not only the highest in Asia after Malaysia but is also uncommon among the economies we examined. A minimum paid-up capital of $2.5M is required for a 100% foreign ownership of a retail establishment.

The required divestment to a stock market sale of 30% percent of equity within eight years is not attractive to foreign entities. It is also discriminatory as it is not required of retail firms owned by Filipinos. We are aware of one foreign company that invested in a chain of retail outlets selling its product that exited in part because of the divestment requirement. In general, firms prefer to make divestment decisions on their own rather than to comply with a regulatory requirement. Such divestment requirements appear in several Philippine laws and are considered a negative factor by foreign investors.

Perhaps another reason is that the local market is well-developed by local retailers who have opened many dozens of malls, and thousand of smaller retail outlets. Some foreign retailers may believe the market already has sufficient competitors and thus might make their entry less profitable than less developed markets in other countries.

Restrictions on Foreign Investment in Retail in Other Asian Countries

We have found information on retail trade investment regimes in eleven other Asian countries, which we summarize below. This data clearly shows that the Philippines is much more restrictive than most other Asian economies. Six of the ten are considered very open to foreign retail investment. India, Indonesia, and Malaysia are partially open. We encourage the Committee to confirm this information and obtain additional data from the Department of Trade and Industry, which can request its foreign trade attaches to verify and supplement our research.

We have the following information on the rules in other countries:

1. Bangladesh. 100 percent foreign ownership is allowed for investment for all items except a few security related materials.

2. Cambodia has no foreign equity requirements (not only for retail but for almost all sectors).

3. China has no restrictions on equity ownership or local sourcing. All foreign investments must be individually approved. The central government has decentralized approvals to cities and provinces, where

local protectionism is balanced against interest in new jobs. Finding appropriate sites and getting local approvals are the major constraints.

4. India currently only permits foreign investment (with a 51% cap) in single brand retail. Like the Philippines it does not restrict wholesale. India is considering relaxing its restrictions to increase allowable foreign equity in the retail sector beyond the current 51% investment cap to allow foreign investment in multi-brand retailing.

5. Indonesia has no foreign equity requirement (but requires the condition that the investor partner with a small-scale Indonesian investor). Indonesia maintains a Foreign Investment Negative List that currently has the following restrictions for foreign investment in retail trading:

a) Supermarkets with a selling space area of less than 1,200m^2;

b) Department Stores with a selling space area of less than 2,000m^2;

c) Mini Markets with a selling space area of less than 400m2;

d) Non-Store Retail Sales of Agricultural Produce, e.g. rice and other crops, fruits, vegetables, etc.;

e) Non-Store Retail Sales of Processed Foods and Beverages, e.g. rice, bread, deep-fried, boiled or steamed cakes and the like, coffee and various sugars, etc.;

f) Non-Store Retail Sales of Chemicals, Pharmaceuticals, Cosmetics and Laboratory Apparatus, e.g. medicinal herbs, cosmetics, etc.;

g) Non-Store Retail Sale of Textiles, Clothing, Footwear and Articles of Personal Use, e.g. shoes, sandals and other footwear, etc.;

h) Non-Store Retail Sale of Household Goods and Kitchenware, e.g. electronic appliances, devices and equipment, plastic/melamine wares etc.;

i) Non-Store Retail Sale of Paper, Paper Articles, Stationery, Printed Matters, Sports Goods, Musical Instruments, Photographic Instruments, and Computers, e.g. photographic and optical devices/equipments, software printing and publication, etc.;

j) Non-Store Retail Sales of Handicraft, Toys, and Paintings;

k) Retail Sale of Fuels and Lubricants, e.g. oil fuel, gas fuel, lubricating oils, and other fuels;

l) Retail Sale of Construction Materials, e.g. cement, limestone, sand, stones and paints, etc.;

m) Retail Sale of Machines (except Cars and Motorcycles) and Spare Parts including Transportation Vehicles, e.g. farm machineries, sewing machines, non-engine driven land transportation vehicle and water transportation vehicles, etc.;

n) Retail Sale of Cars, e.g. car spare parts and accessories, etc.;

o) Rental of Farm, Construction and Civil Engineering Machineries and their equipments; and

p) Other Services i.e. Laundry, Haircutting and Tailoring Services and Beauty Salon.

6. Japan has no restrictions but foreign retailers must comply with local regulations for all retailers.

7. Korea has no restrictions.

8. Malaysia does have a $16 million capital requirement. Foreign retailers have to apply for a license to operate department stores and large supermarkets in Malaysia. To obtain a license, the foreign retailers will have to have at least $16 million in capital. The Malaysian government recently announced it would lift its requirement that equity in domestic market firms to be given to Bumiputras.

9. Singapore allows foreign investment in retail trade without minimum capital investment or other limits.

10. Thailand, under the Amity Treaty with the US, allows US retail companies to invest but has limits on the number of outlets and no procurement requirements.

11. Vietnam since 2009 has allowed fully foreign businesses without equity limitation to engage in retailing activities but restricts the investor initially to a single retail sales outlet. Subsequent outlets are subject to approval from the relevant local Department of Planning and Investment. Local authorities will take into consideration the "masterplan" of the province, including the "economic needs" of the proposed establishment that takes into consideration such factors as available parking and access roads, the number of retail sales outlets already in the locality, and population density. While few cases have been tested, this so-called "Economic Needs Test" remains a significant consideration and potential hurdle for foreign multi-outlet retail chains.

Going Forward: Should the Playing Field Be Level?

We hear a lot from the current administration about making the playing field level for investors. However, it seems the government is talking primarily about reducing red tape and corruption, so that bidding is conducted more fairly. And these are needed, commendable reforms. We are looking forward to hearing from the administration how it intends to make the Foreign Investment Negative List (FINL) more positive even as NEDA is currently preparing the 9th FINL. We commend the leadership of the Congress for its recently-announced initiative to consider amendments to the economic restrictions in the Constitution through a bicameral mechanism.

RA 8762 is a good example of a law that has created an unlevel rather than level playing field, although the intention of the Congress at the time was to open up the retail sector, previously completely closed by 1954 law.

Any assessment of the playing field created by RA 8762 should conclude that the playing field it created contained excessive barriers to foreign investors in the retail sector that have served to discourage rather than attract new investment. **RA 8762 created an obstacle course rather than a red carpet.** The results are apparent in the extremely low level of foreign investment in the retail sector since 2000.

Accordingly, Mr. Chairman, if you ask us, "Should the retail sector playing field be level for foreign investment?" we will answer "Yes, please amend RA 8762 as soon as possible." After more than a decade RA 8762 has turned out to be nearly as protectionist as the old law that it amended.

And your follow-on question, Mr. Chairman, might be "What would proposed amendments look like?" Our position is that investment in the retail sector should be treated as most other domestic market enterprises are in the Foreign Investments Act (RA 7042, as amended by RA 8179). That is to say that the following would apply:

> Small and medium-sized domestic market enterprises, with paid-in equity capital less than the equivalent US$200,000 are reserved to Philippine nationals, Provided that if: (1) they involve advanced technology as determined by the Department of Science and Technology or (2) they employ at least 50 direct employees, then a minimum paid-in capital of US$100,000.00 shall be allowed to non-Philippine nationals.

To legislate this recommendation would simply require amendments to RA 8762 to remove the equity, capitalization, and divestment requirements while retaining the reciprocity provision.

Benefits of Opening the Retail Sector

We believe the entry of more foreign retail investors into the sector in the Philippines will be good for the economy for several reasons.

- Most importantly, it can create jobs at every stage of the retail process and indirectly in those who service the retail sector. One new retail job is not just the sales clerk or the cashier that the customer sees in the store. These are the tip of the retail iceberg, the hidden part of which includes jobs in advertising, agriculture, construction, design, logistics, media, telecommunications, and wholesale retail, among others. In other words, investment in retail sends ripples throughout the economy.

- It can support the more rapid growth of the tourism sector, which is a major priority of the government. Some foreign tourists travel to shop, to Bangkok, Hong Kong, or Singapore. This is especially true of the growing number of Chinese tourists for example, who go all the way to Paris or London to spend their money at full retail prices. More famous brand names and famous department stores operating increasingly in major cities will attract foreign shoppers to this country. Just think of Orchard Road in Singapore or the Bund and Nathan Road in Singapore. We could someday have places like that here.

- Hotels, restaurants, night spots and other tourism sector support enterprises are likewise important and foreign investment should be maximized in all of them to the benefit of the economy.

- More foreign retail players create more competition, which is good for the Filipino consumer, especially the middle class, who can purchase higher quality and more variety of goods at lower costs. Foreign retailers may introduce better technologies for their logistics, inventory management, sales, accounting, and other business operations.

- Foreign retailers also will source their goods locally if they are given quality and pricing comparable to their foreign sources of supply. This can lead to orders from local suppliers to supply not just retail outlets in the Philippines but for export to their outlets in other countries.

In view of the foregoing, we urge the Committee to act with dispatch on the lifting of restrictions under RA 8762. In view of the foregoing, we urge the Committee to act with dispatch on the lifting of restrictions under RA 8762.

Mr. Chairman, thank you for considering our views.

Regards,

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cc: Members of Trade and Commerce Committee