



## The Philippines: Special Economic Zones

### Exploring the Philippines for Factory Relocation

As part of the broad assessment of production bases in Southeast Asia, *HKTDC Research* has undertaken a recent field trip to the Philippines to assess the country's conditions and suitability for Hong Kong companies' manufacturing relocation or diversification. While the previous article, [The Philippines: The Prospect for Manufacturing Relocation](#) touches on the Special Economic Zones (SEZs) this article examines the SEZs specifically, along with location choices facing Hong Kong companies contemplating factory relocation.

### SEZs in the Philippines

The Philippines started developing SEZs in the mid-1990s in order to promote investment, including foreign direct investment ([FDI](#)). Over the past 22 years Philippine SEZs have become a magnet for FDI, especially in attracting manufacturing investment. The Netherlands, Japan, Singapore, the US, and, more recently, South Korea, have been the top sources of investment in the Philippine SEZs.

In the Philippines, manufacturing facilities are concentrated in central and southern Luzon, by far the most developed parts of the country, where there is an abundance of SEZs, including those converted from former the *Clark Air Base* and *Subic Bay Naval Base*.



## Locations of Clark and Subic



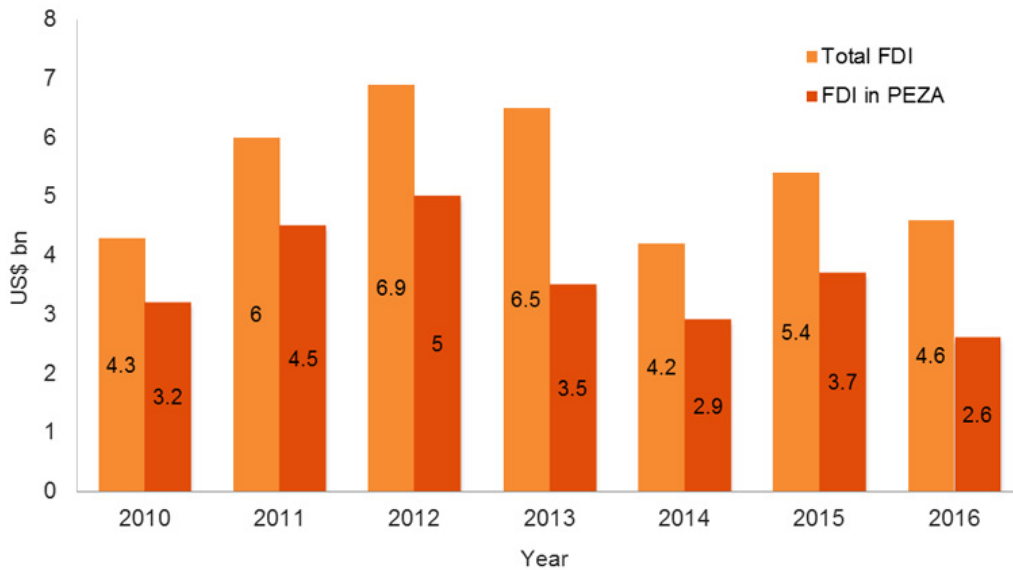
With President Duterte adopting a diplomatic shift towards China, closer economic co-operation between the two countries is expected. The positive repercussions bode well for increased trade and investment from China in coming years, particularly in light of the latter's *Belt and Road Initiative*. This may tie in well with the Philippines' ongoing plans to accelerate infrastructure development, that is, President Duterte's '*Build, Build, Build*' programme, with an expected rise in Chinese investment in Philippine infrastructure projects.

### PEZA - the SEZ Management Body

The *Philippine Economic Zone Authority (PEZA)* is the government agency mandated to develop, manage and promote SEZs to attract investment, both local and overseas. As of April 2017, there were 366 economic zones across the Philippines, of which 74 were manufacturing zones. It is estimated that *PEZA* approves more than half of the Philippines' inward FDI every year. In perspective, more than 40% of the FDI in 2016 went to the manufacturing sector.



## FDI in the Philippines 2010-2016



\* US\$ value based on the average exchange rate of the year  
 Source: Philippine Statistics Authority

As a government agency, *PEZA* identifies and tenders sites for SEZ development across the country. Investors can rent slots in economic zones on long-term leasehold for 50 years, which can be renewed after expiry. *PEZA* is now looking to allow 99-year land leases for SEZs to be on par with other [ASEAN](#) counterparts, such as Vietnam.

Alternatively, manufacturers or private land developers can identify and develop suitable locations. Thereafter, they can apply for *PEZA* status in these privately developed sites. In turn, eligible SEZ tenants need to register with *PEZA* to gain access to the incentives and special customs status.



Inside a privately developed industrial park in Cavite with PEZA zone status.



PEZA offices are set up in privately developed SEZs.

Full foreign ownership is granted to export-oriented operations in the SEZs, with the requirement that at least 70% of the output has to be exported. Businesses serving the domestic market are limited to 40% foreign ownership, except for businesses qualified for pioneer status and with a minimum equity of US\$200,000[1]. Financial incentives are offered in the SEZs to attract investment as outlined below.



### Investment Incentives Offered in SEZs

- Income tax holidays, generally for 4-6 years, capped at 8 years
- Special tax rate of 5% on gross income
- Tax and duty-free import of capital equipment, spare parts and supplies
- Tax and duty-free import of raw materials and supplies used in export
- Zero value-added tax

Other non-fiscal incentives available in economic zones include simplified import and export procedures and assistance in arranging employment visas for non-resident foreign nationals working in the zones. This is largely in line with industrial or economic zones found in many other countries in Southeast Asia.

### SEZs as the One-Stop-Shop for Investment

*HKTDC Research* was invariably in our meetings in the Philippines told that *PEZA* was the recommended window for foreign investors to enter the Philippines. *PEZA* serves as the body to align all government interfaces involved in the set-up and daily operations of businesses.

Generally speaking, foreign investors have to register and apply for permits through at least eight to 10 government departments when setting up a business in the Philippines. While the country's extensive bureaucracy could be frustrating and resources-draining, *PEZA* provides guidance on the investment application process and mediates in the process if needed.

As an aside, the popularity of President Duterte owes much to the perception that he is acting tough to weed out corrupt practices and shake up bureaucracy in the Philippines.

While developing privately owned sites may enjoy the benefit of picking the preferred locations, along with higher flexibility in the desired mix of industry sectors and land use, such an approach cannot sidestep prior dealings with local government nor ignore the interest of people living in the vicinity. The red tape involved in the process can be intimidating and a local partner is essential, particularly if the investment areas contain an element of serving the domestic market with more than 40% of company output. In contrast, those developed SEZs listed under *PEZA* provide a ready-made option for foreign investors. Renting slots in listed SEZs is especially suitable for SMEs with limited resources.

### SEZ in Focus: Clark Freeport Zone

Developed SEZs like the *Clark Freeport Zone (CFZ)* offer a one-stop-shop option for foreign investors. *CFZ* development started in 1995 as part of a reconstruction programme after the catastrophic volcanic eruption of Mount Pinatubo in 1991.

The *CFZ*, some 60km northwest of Metro Manila, was developed from the *Clark Air Base* formerly used by the US, with ready transport links, infrastructure and utilities available for development and expansion. Part of the *CFZ* is designated as a SEZ for manufacturing and services investment.



The *CFZ* has had an accumulated investment of PHP121 billion (around US\$2.5 billion) since it started operations. Not surprisingly, the *CFZ* is now regarded as an economic zone development model in the Philippines.



Factory premises in the Clark Freeport Zone.



Inside a garment factory in Clark Freeport Zone.

The *CFZ* has an advantageous location for manufacturers' supply chain management. It is within two hours drive from Metro Manila, the business and logistics hub of the Philippines. The *Port of Subic (POS)* is also less than two hours' drive for shipment of raw materials and finished products. The *Clark International Airport (CIA)*, which runs both international passengers flights and cargo flights, is within 10 minutes' reach from the SEZ area by car.

As Metro Manila's roads, airports and port are all notoriously congested, the *CIA* and *POS* offer manufacturers the big advantage of bypassing the Metro Manila traffic. Meanwhile, the Philippine government is promoting a 'dual airport' model with a plan to expand services and usage of *CIA* to ease traffic at Manila's *Ninoy Aquino International Airport*. Shipments are also gradually shifting to *POS* due to the congestion in *Port of Manila*. Looking to the future, the *Subic-Clark Cargo Railway* project is a priority infrastructure plan. The flow of goods between *Clark* and *Subic* is expected to be further enhanced in the future.

Unlike any typical brownfield development for industrial use, the *CFZ* is a greenfield project that promotes the zone as a place to work, live and play. Comprehensive community and leisure facilities, such as sports ground, restaurants, shops, clinics, international schools and golf courses are all available within the zone. Schools in the area also work with the *Clark Development Corporation* and businesses to provide relevant vocational training for businesses operating in the zone. Expatriates working in the *CFZ* are offered a pleasant living environment.

However, this development model places restrictions on the industries allowed in the zone. The zone is designated for low-pollution light manufacturing, such as electronics.

Labour-intensive operations are especially welcome as the government is keen to drive local employment through manufacturing. Nonetheless, investors should bear in mind that Philippine wages are towards the upper end of ASEAN pay, as described in [The Philippines: The Prospect for Manufacturing Relocation](#).





Green environment in the Clark Freeport Zone.



Golf course in Clark.

Due to its advantageous geographical location and good infrastructure, the *CFZ* is much sought after by local as well as international businesses, with high occupancy reported. To meet continual demand, the *Clark Green City* project had been launched, developing a new zone of over 9,000 hectares north of the existing SEZ. It is planned as an urban satellite town, with local employment driven by services and manufacturing in the *Clark Green City*.

### Summary

The Philippines is gearing up to compete with other ASEAN manufacturing hotspots for a share of foreign investment, banking on its proven formula of helping foreign investors identify or develop SEZs, along with filling SEZ-based factories with skilled, English-speaking workers. As Sino-Philippine relations begin to improve, it is expected that Chinese investment in both manufacturing and SEZ development will increase.

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[1] The minimum equity requirement can be lowered to US\$100,000 if the business involves advanced technology (subject to review by the Department of Science and Technology) or employs 50 or more staff.

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