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INTERNATIONAL TRADE AND FOREIGN DIRECT INVESTMENT LITERATURE IN THE PHILIPPINES: DEVELOPMENT AND PROSPECTS

Written by
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INTRODUCTION

Trade and investment policies in the Philippines have undergone major shifts through decades. These changes have had important implications on the economy and have been extensively investigated by various scholars. Significant areas which may have important policy implications remain unexplored.

CHALLENGES AND ISSUES FACED BY THE INDUSTRY

Trade liberalization began in the Philippines in the 1980s. The push for this system was primarily due to failed protectionism. Trade liberalization is expected to improve allocation of resources, increase efficiency, and bring domestic prices closer to world price, and these elements are expected to deliver sustained economic growth and development. With the diverse experiences of several countries that have undergone trade liberalization, an unrelenting question persists: Whether or not trade liberalization really delivers its intended promises.

Studies focusing on the productivity effects of trade liberalization reveal diverse results. Research endeavors based on macroeconomic data and trade policy changes, until the mid-1990s, generally discover that trade liberalization in the Philippines had limited impact on productivity. On the other hand, studies that utilized microeconomic data, based on trade policy changes from the mid-1990s onwards reveal more positive productivity effects. Generally, firms that are integrated in world markets are more productive than firms that solely sell in the domestic market. Studies emphasize the need for domestic firms to upgrade their knowledge and skills in order to reap the benefits of trade liberalization (Austria, 1998a; Cororaton and Abdula, 1999).

Meanwhile, studies that investigate on the impact of trade liberalization on economic growth produce negative impact. Majority of the studies still find that real GDP improves with trade liberalization. Nevertheless, variations in sectoral and annual effects exist, depending on the trade reform considered (Cororaton and Cuenca, 2000).

While traditional trade theory predicts that trade liberalization would have favorable income distribution effects (the

Heckscher-Ohlin model, in particular), the empirical literature shows varied evidence. Some studies show income distribution and poverty diminished as a result of trade liberalization. Differences occur through time, trade reforms, economic sectors and considered worker groups.

Traditional literature insinuates that there is race to the bottom among countries participating in international trade. This leads to lower labor and environmental standards. Results of limited studies that tackle these issues realize that trade liberalization does not lead to general environmental degradation (Aldaba and Cororaton, 2001) and implementation of lower labor standards (Edralin, 2000).

INVESTMENT LIBERALIZATION AND ITS ECONOMIC CONSEQUENCES

Like most developing countries, the Philippines has scarce capital and limited access to international financial markets, relative to developed nations. Since capital accumulation is recognized to foster economic growth, FDI is considered as an alternative source of capital. Apart from the inflow of capital, FDI is expected to introduce a myriad of favorable economic effects that promote growth and enhance welfare. Due to these expected benefits, important steps were taken by the government to liberalize investment policy in the Philippines.

Studies show that FDI inflows in the country have displayed unstable patterns of growth and the Philippines lags behind its neighboring countries in attracting FDI inflows, thus, raising the question on whether the country has the necessary conditions and environment conducive for attracting and maintaining FDI.

Most studies show economic factors, such as macroeconomic fundamentals, infrastructure, governance and institutions, are the primary determinants of FDI inflows in the Philippines (Austria, 1998b; ADB, 2005). Meanwhile, fiscal incentives seem ineffective in attracting FDI in the country (Reside, 2006a; 2006b).

An equally important subject of concern is the impact of FDI in the economy. While existing studies generally find that FDI has a positive influence on aggregate economic growth, empirical studies on the impact of FDI on different aspects of the Philippine economy remain scant. Most studies are macro-based, where the Philippines is just one of the research subjects, hence, they fail to provide a detailed analysis of the country.

LIBERALIZATION AND ECONOMIC INTEGRATION

As a result of liberalization efforts, the country's competitiveness improved, enabling it to participate in international production sharing and international trade and investment agreements.

International production sharing (a production scheme that exploits the comparative advantage of different countries in producing different parts and components goods), is one of the drivers of economic intergration. The Philippines participates in this scheme, primarily through labor-intensive production processes. Studies reveal increasing economic integration of the Philippines as suggested by its growing intra-industry trade with trading partners, especially in semiconductors and electrical machineries (Austria, 2002; 2003; 2004). Nevertheless, integration is still considered weak, even with ASEAN member countries. This is due to the variation in the speed of integration and stark differences in the level of development of member countries. Growing concerns for the Philippines include its failure to move to higher value-added segments of the production chain due to lack of local support structures in the country (Austria, 2010) and the emergence of China as an economic power (Austria, 2004).

The Philippines' participation in trade and investment agreements have likewise led to greater economic integration. In spite of being a member of the World Trade Organization (WTO), Austria (2001) it emphasizes the value of regional trade agreements - (i) providing an avenue to overcome trade barriers beyond what can be achieved under the WTO at a faster pace; (ii) enhancing the country's competitiveness; and (iii) enabling the country to address international concerns that can only be addressed at a regional level.

Studies have shown that the Philippines generally gains from its participation in the ASEAN Free Trade Area (AFTA), Asia-Pacific Economic Cooperation (APEC) and Japan-Philippines Economic Partnreship Agreement (JPEPA). These agreements have established economic ties and networks that enhance the country's trade and investment, trade facilitation and economic and technical cooperation.

RESEARCH PROSPECTS

Though numerous studies on various aspects of trade and investment were completed, questions remain unanswered and issues needing further analysis. The following may provide ideas that can stimulate future research.

1. China's trade and investment liberalization have affected the competing sectors in the Philippines in both international and domestic markets. Though this has been recognized in some studies, limited empirical investigation has been found. Future studies can investigate worker displacement or relocation effects as consequences of China's liberalization and its ensuing impact on income inequality and poverty in the Philippines.
2. Most studies analyze the impact of trade and investment liberalization in the Philippines using macroeconomic data. Future studies must use micro level data as they may provide more fruitful results.
3. Other studies focus on the impact of liberalization of trade in goods. Future studies must examine liberalization of trade in services and investigate possible two-way spillover effects between goods and services trade liberalization.
4. An unexplored area of study is the linkage between standards (labor and environmental) and liberalization (trade and investment). An area worthy of future investigation is examining whether firms in different sectors are constrained or encouraged by standards set in international markets.
5. The role of labor union activities and other institutional factors across different industries may be explored when analyzing the trade or FDI-labor market linkage. The impact of institutional factors is often ignored in the Philippine trade and investment literature, but may provide valuable insights.
6. Many studies (see Blonigen (2005) have shown that the choice of estimation technique can significantly alter the results of studies trying to explain the determinants of FDI inflows. Hence, future studies can re-estimate the determinants of FDI inflows in the Philippines using other econometric techniques to verify the results of earlier studies.
7. Future studies can choose an existing FDI policy and analyze its economic importance vis-à-vis the cost of implementing it. An example of such a study is Reside (2006a), which focused on fiscal incentives.
8. Instead of merely identifying the determinants of FDI inflows in the country, future research can identify the contribution of FDI in the sector and region where they go.
9. The Philippines has 35 Bilateral Investment Treaties (BITs). However, very few have received attention in terms of detailed policy analysis and whether the goal of each agreement has been successfully achieved. This is a possible area of future investigation.
10. There is a dearth of studies investigating the impact of FDI on the Philippine economy, leaving a considerable area for future research. Questions of interest include: (i) Does FDI encourage public investments? (ii) Which form of FDI (greenfiled or mergers and acquisitions) is more favorable for the Philippines? (iii) Has FDI affected supplier and consumer prices in different sectors? (iv) Does FDI raise the average wage level in an industry? (v) Does the presence of multinational companies have any impact on working practices of domestic firms?
11. Liberalization of trade and investment seem inevitable. An important thrust of future research is to ascertain the circumstances, where greater economic integration can enhance economic growth and total factor productivity, reduce income inequality and help alleviate poverty across all regions of the country.

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