

Exploring the Philippine FTA Policy Options

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“Regional and bilateral trade areas are hubs of open regionalism. The task before us is how to expand our cooperation to other areas to create interlocking linkages. This should foster multiple linkages in such areas as finance, energy, environment, and peace and security in this part of the world.”

- President Gloria Macapagal-Arroyo

The formation of free trade agreements (FTAs), both regional and bilateral, has been a worldwide trend in recent decades. New generation FTAs have evolved, with elements encompassing trade facilitation and liberalization and covering diverse agenda and other enhanced features of cooperation. This growing phenomenon poses a special challenge not only to the multilateral trading system but also to each individual country's trade agenda, especially with respect to balancing domestic industries' interest vis-à-vis the opportunities of the growing integration of economies.

In the face of growing regional integration and global competition, the Philippines has, as early as the 1980s, shifted its strategy from a protectionist regime to a relatively open economy. In pursuit of regional cooperation, it was a party to the establishment of the Asia Pacific Economic Cooperation (APEC) in 1989 and the creation of the ASEAN Free Trade Area (AFTA) in 1992. It was also a signatory to the World Trade Organization (WTO) in 1995, committing to the principles of multilateralism.

The failure, however, of the two successive rounds in the WTO as well as the rise of Asian bilateralism has prompted the Philippines to jump into the “bandwagon” of FTAs. Recently, the Philippines started engaging in formal FTA negotiations, both *bilaterally*, with Japan for an economic partnership agreement, and *interregion-ally*, for the establishment of ASEAN-China, ASEAN-Japan and ASEAN-India FTAs. Other prospective FTAs involving the Philippines include the US-ASEAN, ASEAN-Korea and the ASEAN-Australia-New Zealand Closer Economic Relations (aside from other bilateral engagements).

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These FTA initiatives basically have a two-fold domain: (a) trade facilitation and liberalization, and (b) enhancement of economic relations. These objectives manifest the Philippines' commitment to greater trade liberalization in this era of globalization. At the same time, the preferential FTAs are considered as *complements* rather than *threats* to the multilateral system of the WTO.¹ Hence, there is recognition that negotiations should keep within the principle of WTO consistency.

Nonetheless, there is increasing consideration about becoming more focused and aggressive in pursuing bilateral or regional arrangements. As such, engagement in FTAs is becoming a significant trade policy tool for the Philippines.

Defining the Philippines' FTA strategy

From the Philippines' previous initiatives and current negotiations, two principles are apparent in the national policy of the government in engaging into a free trade agreement. One is *internal* or domestic in character, which requires that any FTA entered into by the Philippines should be beneficial to the country. At the very least, the country's foreign trade policy in engaging into FTAs should be guided by the following underlying principles and objectives of reforms: (1) global competitiveness, (2) sustainable growth, (3) efficiency in allocation of resources, and (4) poverty alleviation. And two is *global* in perspective, which provides that these FTAs should be in accord with our multilateral commitments and toward the achievement of the multilateral goals. Notwithstanding these preconditions, however, there are no concrete strategies

¹ Foreign policy statement of President Gloria Macapagal-Arroyo.

² The potential risks or costs of entering into FTAs are trade diversion, resource diversion (where government resources diverted away from multilateral negotiations) and political diversion (which could deplete political capital in doing domestic reforms).

³ "Spaghetti bowl effect" may arise due to the differential tariff rates for FTA member and nonmember countries. Thus, the "spaghetti strands" may emanate out of many different and overlapping directions, with consequent negative welfare effects (Bhagwati and Panagariya 1996).

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or deliberate policies toward FTAs. The Philippines appears to be more of a passive negotiator or participant in FTAs. This position is not necessarily disadvantageous since there are potential risks in engaging in FTAs.² In the long run, however, not having a systematic framework in FTA negotiations would result in what Jagdish Bhagwati refers to as the "*spaghetti bowl effect*."³

There is no template for an ideal FTA strategy. However, a country should at least be able to have a clear objective with respect to the *elements* of an FTA, the *scope* and institutional framework, the assurance that the FTA is *more than an FTA per se* and is a mechanism toward achieving a stronger purpose, and the *criteria for choosing a partner* to the FTA. The country could also benefit from the different models of FTAs entered into by the prospective partners. And as previously mentioned, there has to be an explicit adherence to and consistency with the WTO thrusts.

Defining the elements of FTA

Entering into an FTA provides an avenue for the country to overcome existing and emerging barriers to trade beyond what can be achieved within the multilateral framework. It increases the country's competitiveness, enabling it to compete better in the global economy (Austria 2003). And even if FTAs are very much about market access and investment liberalization in general, they may serve as instruments that can allow the country to look further in terms of investment attraction, trade facilitation, institution-building, technology upgrading and industry competi-

tiveness. Industry-by-industry adjustment and competitiveness strategies must thus be mapped out by the government with industry leaders in order to maximize the potentials of the FTA and manage the challenges of integration of economies (Intal 2004).

Ideally, then, the FTA strategy should be seen as a complementary tool in the country's development and competitiveness strategies, with impact on the three pillars of the FTA, namely, goods, services, and investments. As such, the identification of what provisions can be negotiated along these pillars, what may be committed and unbound, and what conditionalities and special issues need to be addressed, should be done within this overall development framework.

Determining the scope

In the context of multilateralism, FTAs serve as exception to the most-favored nation (MFN) clause. Hence, the need for substantial elimination of all trade barriers with respect to goods and substantial sectoral coverage with respect to services.⁴ These should serve as the minimum for a preferential agreement.

With respect to goods, trade barriers have gone beyond the tariff and quota restrictions. The salient issue now is with respect to the use of sanitary and phytosanitary (SPS) measures, i.e., whether they are merely regulatory mechanisms or actually nontariff barriers to trade. As a developing country, the Philippines has a difficulty in complying with the strict requirements of a developed country's SPS measures. If the standards cannot be negotiated, then the country should push for the provi-

sion on cooperation and support in capability-building for compliance with such measures.

Another important task for the government, apart from determining what the country wants, is the identification specifically of its sensitive products. Prior to the start of the negotiation, there must already be a classification of what products are negotiable and nonnegotiable. This is especially relevant if FTA partners are to adopt a negative listing approach. Otherwise, there might be a scenario where a prospective partner will make reservations on all products covered, thereby reaching a point where all the products seem to be excluded or protected from that country's perspective.

Meanwhile, other possible issues that the government needs to address would be in services liberalization. For instance, should the FTA stick to the GATS or GATS plus in services liberalization?

FTA plus provisions

Aside from the traditional FTA issues, attention should also be given to the so-called enhancing features of new age FTAs. This would generally include rules on investments, competition policy, government procurement, transparency and trade facilitation measures. Aside from the fact that they facilitate trade, these provisions would also serve as institutional safety nets for each FTA partner or member state. The objectives of the FTA would be better achieved if in the case especially of a developing country, provisions on cooperative undertakings, support and assistance in the areas of technology transfer, human resource development, environment, small and medium enterprises (SMEs) and infrastructure development are included.

Finally, institutional mechanisms such as trade remedies and dispute settlement mechanisms should put emphasis on mutually agreed solutions and take into consideration other existing mechanisms like that of the WTO and other FTAs which may have proper concurrent jurisdiction. There must be certain criteria as to what forum should apply in a particular dispute in order to prevent

⁴ FTA conditionalities include: **For trade in goods** - 1) members of an FTA are not permitted to raise trade barriers (both tariff and nontariff) against nonmembers; 2) members of an FTA must eliminate, rather than lower, *substantially* all trade barriers among themselves; and 3) members must achieve free trade among members by a certain date. **For trade in services** - 1) the FTA must have substantial sectoral coverage in terms of the number of services sectors and volumes of trade; 2) members of an FTA must eliminate existing discriminatory measures and/or prohibit new or more discriminatory provisions in these services sectors.

cases of forum shopping where substantial rights or obligations of both the multilateral and preferential agreements are affected.

Choosing an FTA partner

A country's FTA policy should not only focus on what type of preferential treatment to give regardless of another partner state; it should also have an established set of criteria in choosing an FTA partner. This is particularly important in the case of engaging into bilateral agreements. There is a current trend especially in East Asia that developed countries like Japan and the U.S. engage in bilateral initiatives with individual ASEAN members. For the Philippines, engaging in bilateral agreements with its largest trading partners could maximize the potentials of its trading relationship. However, an important but sometimes neglected query is whether it will also be advantageous to enter into potential bilateral FTAs with countries where the Philippines has negligible trade.

It would be useful to review the established set of criteria in choosing an FTA partner of countries who have already engaged or negotiated in various FTAs. The United States requires that a prospective partner must be a member of the WTO and should have an existing Trade and Investment Framework Agreement (TIFA) with the former. On the other hand, Japan's criterion in choosing an FTA partner is generally based on (a) economic criteria, (b) geographic criteria, (c) political and diplomatic criteria, (d) feasibility criteria, and (e) time-related criteria (MOFA 2002).⁵

These criteria are important because the extent and magnitude of the winners and losers on the FTA will depend on the choice of a partner or partners. As a whole, the welfare effect of the FTA is the paramount consideration in choosing a partner. Thus, factors such as eco-

⁵ Ministry of Foreign Affairs. 2002. Japan's FTA strategy (Summary).

⁶ Other measures such as proximity, income convergence, intrafirm trade and policy convergence have also been suggested by Haggard.

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nomie preconditions, size of the partner, potentials for bilateral trade expansion, and those beyond static gains should be taken into consideration (Avila et al. 2003).⁶

Taking these factors into consideration, it can be argued that the Philippines can derive maximum benefits from bilateral agreements with its major trading partners, specifically the U.S. and Japan, because trade with them account for a big chunk of the country's exports and imports. The U.S., for instance, accounted for almost 28 percent of Philippine exports (estimated at US\$8.9 billion) and 16 percent of the latter's imports (US\$5.2 billion) in 2001. Japan, the second largest trading partner of the Philippines after the United States, meanwhile, accounted for 14 percent of Philippines exports and 19 percent of the latter's imports also in the same year.

It can be argued that bilateral agreements could be beneficial and strategic for the country at this point in time. However, to manage the risks that could arise from having FTAs, the number of these bilateral agreements should be limited to those with greatest positive potential impacts.

The growing Asian liberalization and the potential East Asia FTA

There is currently an increasing trend in the East Asian economic integration. One of the major factors in this concentration of intraregional trade has been the remarkable increase in international production sharing. Indeed,

East Asian regionalism appears to be characterized and stimulated more by dynamic developments in markets rather than by formal political institutions, such that the convergence of East Asian markets is actually happening even before a formal integration phase (Krumm and Kharas 2003). Nonetheless, a need for a formal FTA is increasingly being felt owing to still fragmented markets within the region characterized by a diversity of cultures, economic and political structures.

Consequently, there is also a plethora of proposals for both bilateral and regional arrangements in the region. As such, it is not unlikely that an East Asia-wide FTA would be achieved sooner or later. This is inevitable given the growing sentiment that trade liberalization within the ambit of the WTO and APEC has not been making substantial progress. In addition, taken in light with China's accession to the WTO, the successful European Community (EC) integration and the impending Free Trade Agreement of the Americas (FTAAs), there is likewise an increasing call for the creation of a "strategic alliance" if only to enable the Asian region to face the current global trading movement.

In comparison to Europe, Asian regionalism is not well-institutionalized since it operates by consensus in regional organizations over almost all collective actions. The EC experience, however, cannot be totally compared with that of the Asian regionalism because the scope, depth and character of regional integration processes vary across

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both numerous dimensions and among world regions. The Asian inclusive character is more of a *network-style* integration (Katzenstein 1996).

What is evident is that the economic integration in the East Asia region or the ASEAN plus three is underway. Indeed, initiatives toward such integration have actually been emerging for at least the last two decades as shown in the examples below.

Early regionalism

The 1980s marked the growth of regional forces in world politics, and Asia was no exception. Intra-Asian trade, a frequently used measure of regional integration, has increased greatly in the early 1980s⁷ (Bergsten and Noland 1993). Although the ASEAN Declaration of August 8, 1967 might have started the regional cooperation, it is believed that one defining force in the increase in trade was the Declaration of the ASEAN Concord in Bali on February 24, 1976. Since then, further regionalism trends like APEC in 1989 and the ASEAN Free Trade Area (AFTA) in 1992 have emerged.

Mahathir's proposal

The formation of the then infamous all-Asian "East Asian Economic Caucus" (EAEC), a cooperation of Southeast Asia and Northeast Asia, was first proposed by Malaysian Prime Minister Mahathir Mohamad in 1990. This idea, however, did not take root after the United States expressed strong opposition to it (Chalermphanupap 2002).

Institutionalization of ASEAN+3

The first step in the evolution of the ASEAN+3 was the round of visits of then Japanese Prime Minister Ryutaro Hashimoto to the ASEAN countries in 1997. Unexpectedly for Japan, the ASEAN proposed a summit among the ASEAN countries, Japan, China and South Korea (Yoshida 2004).

⁷ It was also at this time when the regional political developments in Northeast and Southeast Asia were competing for European attention (Katzenstein 1996).

Asian monetary crisis and the role of Japan

Japan's participation in East Asian regionalism began with the outbreak of the Asian monetary crisis in 1997. Aside from the earmarked US\$17.3 billion for the ASEAN countries during an IMF-support conference in Tokyo, Japan also formulated and introduced the concept of an Asian Monetary Fund.⁸ It was during this time that the first ASEAN+3 Summit was held and the New Miyazaka Initiative⁹ was decided. Along with the continued financial assistance from Japan has been the conduct of subsequent ASEAN+3 fora (Yoshida 2004).

It should also be noted that on the fourth meeting of the ASEAN+3, when a task force was looking at the possibility of an ASEAN free trade zone, ASEAN-China leaders and Chinese Premier Zhu Rongji endorsed the establishment of a free trade area between China and the ASEAN economies within 10 years. Consequently, other countries have shown interest in entering into FTAs with the ASEAN, with proposals coming from Japan, Korea and the U.S. in its "Enterprise for ASEAN Initiative" (Pangestu 2003).

Japan's accession to the ASEAN Concord

On July 2, 2004, Japan, with the consent of the Southeast Asia, acceded¹⁰ to the ASEAN Concord, including its first and second protocol amendments. The ASEAN Concord embodies the members' commitment to deepening and broadening its economic integration and linkages with

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the world economy to realize an ASEAN economic community as well as to further build on the momentum already gained in the ASEAN+3 process. The goal was to further draw synergies through broader and deeper economic cooperation in various areas (ASEAN Concord II).

Framework for the East Asia FTA

The framework for the East Asia FTA finds its basis on the "Joint Statement on East Asia Cooperation" (Manila 1999) which declares that the future issues of concern for ASEAN+3 would include economic; monetary and financial; social and human development; scientific and technological development; culture and information; development cooperation; and political and security issues. Several ministerial level meetings and two working groups have been organized since then. In the ASEAN+3 Summit, short-term measures like the formation of an East Asia Forum and an East Asia Business Council as well as long-term measures like the formation of an East Asia Free Trade Area and the evolution of the ASEAN+3 Summit to an East Asian Summit were introduced. The process of the East Asian regionalism has been progressing along two tracks, one on *financial cooperation* and another on the formation of an *Asian economic community* (Young 2004).

Regional in perspective

There is no question that economic liberalization through FTA formation should go beyond mere liberalization and facilitation of trade of individual countries. At the very least, it should include areas of capability-building and human resource development, infrastructure development and even regional coordination of national policies.

Nevertheless, these initiatives should be geared towards community cooperation. This is necessary because the

⁸ This was frustrated by strong opposition from the U.S. as it would be an "easy money" for Asian countries.

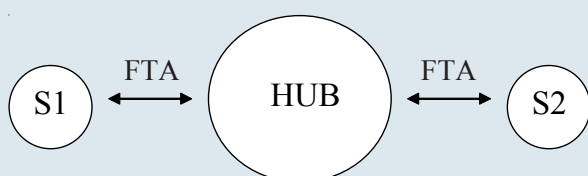
⁹ A US\$30 billion capital financial support package named after Finance Minister Kiichi Miyazaka.

¹⁰ This was signed by the Japanese Minister of Foreign Affairs, Yoriko Kawaguchi.

Box 1. Hub-and-spoke system

The recent proliferation of bilateral agreements has created a number of “hub-and-spokes” type of trade relationship. Figure 1 illustrates the concept of a simple hub-and-spokes arrangement: one economy becomes a “hub” by establishing two different bilateral FTAs with a number of other nations herein the two spokes (S1 and S2) while those spokes retain their MFN barriers on each other's goods.

Figure 1. Basic hub and spokes structure: a stylized model



Source: Das and Andriamananjara, 2004.

rapid integration of the world has given birth to global concerns that could only be effectively addressed through stronger regional cooperation. This is particularly important to East Asia where much of the liberalization benefits would be achieved through a complementarity of production and exports within the region. Hence, a general framework within the East Asian region should eventually evolve.

ASEAN as the link

With the exception of the Philippines' strategic need for special bilateral agreement with some other countries, the country should participate more as part of the ASEAN in movements toward economic integration. This would reduce some of the costs, biases and difficulties of a bilateral FTA approach.

¹¹ Opening Address at the ASEAN Leadership Forum, Kuala Lumpur, 22 March 2004.

Many of the proposed FTAs in East Asia are of the so-called “hub and spoke” pattern (Box 1). The concern here is that the balance of advantages in “hub and spoke” arrangements will tend to favor the hub because of its stronger bargaining position and greater attractiveness of its central location to investors. In this regard, the possibility of having the ASEAN as the hub may be explored.

Beyond the achievement of FTA


East Asia FTA is actually viewed as a “trade for development” strategy within the region. This should be seen more as an opportunity to create “interlocking linkages” which would not merely lead to the national interests of each country but also promote the development of the region itself. This FTA should also be seen as a means rather than an end in the light of the multilateral agenda.

A call to leadership

Regional cooperation calls for a special type of leadership. In the words of ASEAN Secretary-General Ong Keng Yong, “the challenge is how ASEAN (or ASEAN+3 in this case) can provide the leadership in managing regional interdependence and its impact and in overcoming some inherent contradictions between being competitive and being part of a community.”¹¹

Concluding note

There is enough motivation for the envisioned East Asia Economic Community to push forward and challenges are on the way. Whether or not this East Asia FTA will be a trade bloc, the long-run agenda should be to minimize the risks arising from FTA formation.

In sum, multilateralism should still be the ultimate goal. Preferential agreements could be entered into, *bilaterally* where benefits can be maximized or specific concerns addressed, and *regionally* to serve as catalysts for development and mechanisms for a more orderly global trade order. In these endeavors, consistency with the WTO in the long run should always be kept in mind. 

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