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Liberalization and Regional Integration: The Philippines' Strategy for Global Competitiveness*

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ABSTRACT

The paper examines the policies pursued by the Philippines in response to the increasing economic integration and interdependence of nations and regions around the world, focusing in particular on the country's multitrack approach to trade and investment liberalization. The country's experience points to the importance of domestic policies that foster domestic efficiency and competitiveness before one can participate in regional integration and face global competition. The country first pursued trade and investment liberalization policies in the 1980s and 1990s to eliminate the inefficiency of domestic industries arising from its past protectionist regime. The unilateral liberation efforts resulted in a better allocation of resources and improvement in the overall competitiveness of domestic industries. The improved competitiveness enabled the country to participate in the 1990s in regional trading arrangements—AFTA and APEC—and in the much bigger WTO. The challenge facing the country now is how to deepen and expand its participation in regional integration as the proliferation of regional trading arrangements has brought forth many new competitors for the country, both for its export markets and its sources of foreign direct investment. Areas requiring further reforms are identified to enable the country to realize the full gains from economic integration.

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INTRODUCTION

Globalization and the rapid development of information and communications technology have deepened the economic interdependence of nations and regions around the world. Markets are opened allowing producers to penetrate more markets and consumers to have greater choices. The new competitive setting requires greater competitiveness so that each nation can participate in and benefit from globalization.

Greater openness and economic integration, however, require strategic policy formulation; otherwise, one runs the risk of being caught unprepared or left behind. To do this, one needs to act on three fronts: national, regional and multilateral. The development experience during the past two decades has shown that for a country to face globalization and participate in economic integration, it must have domestic industries that are efficient and competitive. Economic integration presupposes that participating economies have already attained a high level of competitiveness and maturity of their production structures to be able to face regional and global competition (Onguglo and Cernat 2000). This is where a country's unilateral trade and investment liberalization policies play a major role. That is, by fostering domestic efficiency where resources are allocated according to a country's comparative advantage, liberalization policies enable industries to prepare for global competition. But as industries become competitive, they require bigger markets to realize economies of scale. Regional integration and multilateral cooperation then become important as they provide a country the opportunity to penetrate larger markets.

This paper examines the policies pursued by the Philippines in response to the new international trade environment, focusing in particular on the country's multitrack approach to trade and investment liberalization. The paper starts in Section 2, which discusses the country's unilateral efforts on trade and investment liberalization and reforms in the services sector, including the impacts of the reforms on the economy. Section 3 presents the progress in the implementation of the country's commitments in

the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation (APEC), and the ASEAN Free Trade Area (AFTA). Section 4 addresses the challenges and prospects of deepening and expanding the country's economic integration, focusing on the implications on the country of expanding AFTA for inter-regional trade. Section 5 concludes by identifying the areas where further reforms are necessary to enable the country to realize the full gains from economic integration.

UNILATERAL APPROACH TO LIBERALIZATION

The Philippines has a long history of protectionist regime. Prior to the 1980s, the country was a classic case of the 'import substitution syndrome.' Industry incentives were distorted, first, by protection, which was carried out through tariffs, import and foreign exchange controls, and overvaluation of the peso; and second, by capital market intervention favoring heavy industry over light industry. These instruments adversely affected the efficient allocation of resources by creating bias in favor of import-competing manufacturing industries over exports and agriculture, and in favor of consumer goods over capital and intermediate goods. The end result was an imperfectly competitive structure characterized by unrealized scale economies and poor economic growth performance.

The adverse effects of antitrade and protectionist regime could no longer be ignored as social and economic unrest grew toward the end of the 1970s, prompting the government to undertake major reforms beginning in the 1980s. Indeed, the past two decades have witnessed the implementation of substantial industrial reforms in the Philippines through trade and investment liberalization. Complementing the industrial reforms are the reforms in the services sector through liberalization, deregulation, and privatization. The reforms were aimed at improving efficiency and resource allocation, and attaining global competitiveness and sustained economic growth (Medalla 1998).

Trade liberalization

The country has pursued a series of Tariff Reform Programs (TRP) since 1981 to reduce the overall level of protection and the dispersion of tariff protection within and across sectors and industries. The first phase (TRP I) was implemented in 1981-1985, where tariff rates were reduced from a peak of 100 percent to a maximum of 50 percent. The average nominal tariff fell from 42 percent in 1981 to 28 percent at the end of TRP I.

TRP was temporarily put on hold during the second half of the 1980s because of the prevailing political and balance-of-payments crises at the time. During the period, however, the country implemented the Import Liberalization Program (ILP), designed to gradually remove nontariff restrictions on imports, mainly import licensing requirements or outright import ban. The program resulted in the reduction of regulated items from 34 percent of the total PSCC lines in 1985 to 3 percent in 1996 (De Dios 1997).

Tariff reform resumed under TRP II with the implementation of Executive Order (EO) 470 in August 1991. This phase ended in 1995 with tariff rates clustering around three bands: 10 percent, 20 percent and 30 percent.

The current round of tariff reforms (TRP Phase III, 1996-2003) aims at a uniform tariff rate of 5 percent by 2004. Toward this end, a series of Executive Orders (EO) was issued to gradually restructure the economy, namely, EO 189 (machinery and capital equipment), EO 204 (garments and textiles), EO 264 (industrial products), EO 288 (nonsensitive agricultural products), and EO 311 (tariffication of quantitative restrictions in agricultural commodities). Since 1996, tariff rates have been clustered at 3 percent (Appendix, Table 1).

Tariff adjustments were also made in response to the adverse effects of the financial crisis on the economy. EO 465 was issued in 1998 and EO 63 in 1999 to alleviate the difficulties faced by domestic industries adversely affected by the crisis. The applied tariff rates on 694 tariff lines for chemicals, textiles, metals and machinery were temporarily raised to a level at or below those bound in WTO in 1999, after which they were reverted to their old rates (WTO 1999).

Table 1 shows the reduction in nominal tariff rate and effective protection rate (EPR) as a result of the series of tariff reforms. The higher EPR of agriculture in the 1990s compared to 1985 was the result of the tariffication of quantitative restrictions in agricultural products. The gap in EPR between agriculture and manufacturing has been substantially reduced.

Competitiveness. One significant effect of trade liberalization is the increase in the overall competitiveness of the manufacturing industry, as measured by the ratio of the domestic resource cost with the shadow exchange rate (DRC/SER)[1] (Pineda 1997). The DRC/SER ratio went down from 1.5 in 1988 to 1.2 in 1994. Industries that maintained or improved their efficiency and competitiveness were mostly export-oriented ones. Trade liberalization also resulted

Table 1. Average nominal tariff and effective protection rates, 1985-2000 (%)

Sectors	1985	1995	1996	1997	1998	1999	2000
Nominal tariff rates							
Agriculture	35.00	28.00	28.29	25.28	18.91	16.33	14.40
Mining	-	-	5.25	4.73	3.58	3.51	3.27
Manufacturing	27.00	19.00	13.37	11.38	9.36	8.98	6.91
Overall	28.00	20.00	15.55	13.43	10.69	9.98	7.96
Effective protection rates							
Agriculture	9.20	19.70	22.19	19.18	14.27	14.83	14.84
Mining	6.10	1.10	0.30	0.79	0.55	0.41	0.43
Manufacturing	55.90	22.20	28.16	24.00	13.50	17.83	17.78
Overall	38.00	20.40	25.43	21.78	13.17	16.32	16.30

Source: Tariff Commission

[1] DRC measures the social cost of domestic resources used per unit of net foreign exchange earned or saved by an activity. SER on the other hand, represents the opportunity cost of domestic resources used in all activities producing tradable goods or the social cost of earning foreign exchange. The DRC/SER ratio, therefore, measures an activity's efficiency in earning or saving foreign exchange. An industry with a DRC/SER ratio of less than or equal to 1 is considered competitive and efficient; if the ratio is greater than 1, the industry is considered uncompetitive and inefficient. However, in the study quoted above, this strict criterion was relaxed to take into consideration possible measurement errors. An industry is therefore considered competitive and efficient if the DRC/SER ratio is 1.2 and uncompetitive and inefficient if the ratio is greater than 1.2.

Table 2. Resource allocation and efficiency, 1988 and 1994

DRC/SER	Efficiency classification	Share in production value (%)		Share in number of establishments	
		1988	1994	1988	1994
0 DRC/SER< 1.0	Highly efficient	39.5	41.6	30.2	22.4
1.0 < DRC/SER < 1.5	Efficient to mildly inefficient	22.8	37.9	27.7	40.5
1.5 < DRC/SER < 2.0	Inefficient	14.7	7.6	13.0	16.3
DRC/SER > 2.0	Highly inefficient	21.8	12.9	26.6	20.8
Average DRC/SER		1.5	1.2		

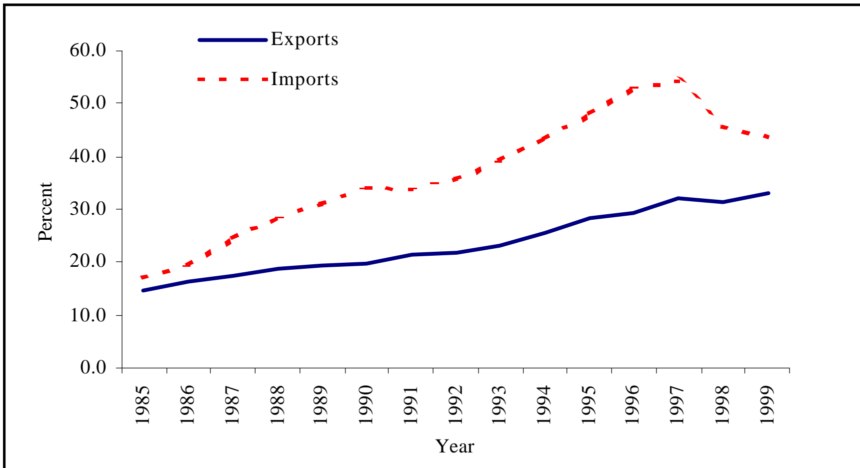
Source: Pineda (1997)

in better allocation of resources, as shown by the increase in the share of efficient establishments in the total value of production (Table 2). Nonetheless, much work still needs to be done as the share of inefficient establishments remained significant.

Export performance. The increasing ratio of merchandise exports and imports to GDP since 1985 clearly indicates the increasing openness of the economy to the world market (Figure 1). The decline in the ratio of imports to GDP in 1997-1998 was due to the financial crisis.

Unfortunately, the reductions in tariff and import restrictions have not been accompanied by a consistent exchange rate policy that favors (or is neutral to) exports (Austria 1997). The real effective exchange rate depreciated by 31.1 percent during the period 1982-1988. This helped enhance the competitiveness of the export sector during the early phase of reforms. However, from 1989 to 1996, the real exchange rate continuously appreciated because of the increase in foreign investment. Although the ASEAN economies all experienced an appreciation of their currency, the Philippines appreciated the most in the 1990s, resulting in the loss of its competitiveness vis-à-vis major competitors in the region (Intal 1997). The effect of this was an export growth in the 1990s that was lower than that of the latter half of the 1980s (Table 3). The peso depreciation during the financial crisis in 1997-1998 did not help boost exports as the sector grew only by 3.6 percent. Growth started to pick up, however, in 1998-1999 at 7.8 percent.

Figure 1. Ratio of merchandise exports and imports to GDP, 1985-1999 (1985 prices)



Source: National Income Accounts

Table 3. Average annual growth rate of merchandise exports and imports (%)

	Exports	Imports
1985-1990	11.3	20.0
1990-1995	9.7	9.4
1995-1999	7.3	1.0

Source: National Income Accounts

The commodity composition of exports has also changed remarkably since the 1980s (Table 4). The share of traditional exports (coconut, sugar, forest products, mineral products, fruits and vegetables, abaca and tobacco) has been going down while the share of nontraditional exports (semiconductors, garments, wood furniture) has been going up. In particular, the semiconductors and electronic microcircuits have become the country's leading exports since the mid-1980s, with their share to total exports increasing from 30 percent in 1985 to almost 69 percent in 1999.

Table 4. Philippine exports, by major categories, 1985-1998

Category	Value (million US$)				Percent distribution (%)			
	1985	1990	1995	1998	1985	1990	1995	1998
Traditional exports	1,301	1,437	1,970	1,649	28.11	17.55	11.29	5.59
Nontraditional, manufactures	2,767	5,995	14,224	26,060	59.78	73.23	81.53	88.35
Nontraditional, unmanufactured	561	754	1,253	1,788	12.12	9.21	7.18	6.06
Total	4,629	8,186	17,447	29,497	100.00	100.00	100.00	100.00

Source: Philippine Statistical Yearbook, NSCB

However, the heavy reliance of the country on semiconductors and electronic microcircuits for its export earnings is now becoming a concern because of their high import content and low value-added (World Bank 1997). This is further supported by the UNCTAD Report (1999) that high-technology manufactures accounted for only 27.6 percent of the country's merchandise exports, in contrast to the country's neighbors in the region (except Indonesia whose performance is worse than the country's) (Table 5). If the country were to improve its competitiveness in a globalizing world, its export base would have to change from primary and labor-intensive exports to high value-added and high-technology products.

Table 5. Exports on technology manufactures as a percentage of total merchandise exports, 1997 (%)

Country	High-tech manufactures	Medium-tech manufactures	Low-tech manufactures	Resource-based manufactures
Singapore	58.35	15.33	7.28	10.73
Taiwan	36.55	19.32	32.74	4.81
Korea	28.83	24.26	23.67	9.22
Hong Kong	28.27	11.52	48.72	4.39
Indonesia	5.77	6.67	17.36	18.80
Malaysia	47.57	13.13	10.79	14.66
Philippines	**27.65**	**3.70**	**11.54**	**6.44**
Thailand	31.39	12.58	20.27	12.80
China	17.25	13.15	49.39	7.60
India	5.72	9.60	38.17	20.29
Mexico	30.95	28.83	18.79	5.39

Source: *World Investment Report,* 1999

Industry performance. The reforms, however, have not produced significant change in industrial growth yet. This is shown by the slow growth of the manufacturing sector (Table 6) and the sector's almost constant share in GDP (Table 7). Medalla (1998) argued that "gains from trade reforms are more long-run in nature and may not readily be apparent." It is expected, however, that as the industries have adjusted to the new environment brought about by the reforms, industrial growth will eventually pick up.

Table 6. Average annual growth rate, by sector, 1990-1999 (%)

Sector	1990-1995	1995-1999
Agriculture	1.5	1.5
Industry	2.1	2.8
Manufacturing	2.0	2.5
Services	2.6	4.8
GDP	2.2	3.4

Source: *Philippine Statistical Yearbook,* 1999

Table 7. Distribution of GDP by sector, 1985-1999 (%)

Sector	1985	1990	1995	1999
Agriculture	24.6	22.4	21.5	20.0
Industry	35.1	35.6	35.4	34.5
Manufacturing	25.2	25.5	25.3	24.5
Services	40.4	42.0	43.1	45.5

Source: National Income Accounts

Investment liberalization

Just as the country's trade regime underwent significant reforms during the last two decades, so has the investment regime. The government has sought greater foreign investment by expanding areas and industries open to foreign investors. Prior to 1991, eligibility for 100 percent foreign equity was subject to the approval of the Board of Investments. However, the passing of Republic Act (RA) No. 7042, known as the Foreign Investment Act of 1991, liberalized foreign investment by allowing foreign equity participation of up to 100 percent in all areas, except those specified in the Foreign Investment Negative List (FINL). In 1996, further legislation was passed allowing greater foreign participation in previously prohibited sectors. This, in effect, shortened the foreign investment negative list.

Restrictions on foreign direct investment (FDI) are now limited to two areas: (1) Negative List A, which includes areas reserved for Filipino nationals by virtue of the Constitution or specific legislation like mass media, cooperatives, or small-scale mining; and (2) Negative List B, which includes areas relating to defense, risk to health and morals, and protection of local and small- and medium-size industries. Examples of these investment areas are the manufacture of firearms and gunpowder, and sauna and steam bath houses.

All foreign investors are entitled to the basic rights provided in the Constitution, such as remittance of earnings, freedom from expropriation and requisition of investment, and full and immediate repatriation of capital and remittance of dividends without prior approval by the Bangko Sentral ng Pilipinas (BSP), provided the foreign investment has been registered with the BSP.

The change in the country's investment policies has been a crucial factor in building up confidence in the economic prospects of the country. The value of FDI in the country increased from an annual average of US$518 million during the period 1987-1992 to US$1,460 million during the period 1993-1998 (Table 8). Nonetheless, the country's performance in attracting FDI is still below its neighbors in the region. The country's average share in the total FDI inflows to South, East and Southeast Asia went down from 2.8 percent in 1987-1992 to 2.1 percent in 1993-1998. As the table shows, India and Vietnam have already overtaken the country in attracting FDI.

Reforms in the services sector

The many regulations in the services sector have rendered the sectors inefficient. Since services are also inputs into the production of industries, their inefficiency weakens the competitiveness of the industry sector and hence, can be costly to the economy as a whole. Hence, to further improve the country's competitiveness, the reforms in the trade sector are being complemented by the reforms in the services sector. Much of the reforms, however, are still ongoing.

Banking. Competition has been enhanced by decontrolling interest rates, allowing a limited number of foreign banks domestic license, lifting the moratorium on opening of new commercial banks, and substantially relaxing the regulations on bank branching. Two major laws were enacted: (1) Republic Act 7906, which provided for the regulation of the organization and operations of thrift banks; and (2) Republic Act 7721, which liberalized the entry of foreign banks in the country by allowing foreign equity partnership of up to 60 percent of the voting stock of existing domestic banks or the incorporation of a new subsidiary in the country, and the entry of new foreign bank branches with full banking authority.

The reforms granted licenses to 10 new foreign banks, in addition to the original four. The increased presence of foreign banks has induced more competition in the banking industry, encouraging domestic banks to improve their services and products, globalize their operations, and build capitalization (Lamberte 1996).

Insurance. The main instrument liberalizing the insurance sector is the Department of Finance Order No. 100-94, which allows foreign insurance companies to operate in the country. Likewise, under Republic Act 8179, amending the Foreign Investment Act of 1991, the “Negative List C” has been abolished, signifying that insurance companies can now be 100 percent foreign-owned.

Telecommunications. Deregulation of the telecommunications industry started with the issuance of Executive Order No. 59 in 1993. The EO called for the compulsory interconnection of all telecommunication facilities, effectively abolishing the monopoly held by the Philippine Long Distance Telephone (PLDT) Company since 1928. In July of the same year, EO 109 was also issued, requiring all cellular mobile telephone system and international gateway facility operators to install at least 400,000 and 300,000 telephone lines, respectively, within five years. By the end of 1998, 78.7 percent of the total required telephone lines had been installed (NTC 1998).

Table 8. FDI inflows, 1987-1998

Country	1987-1992	1993	1994	1995	1996	1997	1998
Value (in million US$)							
Singapore	3,674	4,686	8,550	7,206	7,884	9,710	7,218
Taiwan	1,127	917	1,375	1,559	1,864	2,248	222
Korea	907	588	809	1,776	2,325	2,844	5,143
Hong Kong	1,886	3,657	4,131	3,279	5,521	6,000	1,600
Indonesia	999	2,004	2,109	4,346	6,194	4,673	(356)
Malaysia	2,387	5,006	4,342	4,178	5,078	5,106	3,727
Philippines	**518**	**1,238**	**1,591**	**1,478**	**1,517**	**1,222**	**1,713**
Thailand	1,656	1,805	1,364	2,068	2,336	3,733	6,969
China	4,652	27,515	33,787	35,849	40,180	44,236	45,460
India	58	550	973	2,144	2,426	3,351	2,258
Vietnam	206	1,002	1,500	2,000	2,500	2,950	1,900
Total for South, East and Southeast Asia	18,569	49,798	61,386	67,065	79,397	87,835	77,277
As a percentage of total FDI inflows to South, East and Southeast Asia (%)							
Singapore	19.8	9.4	13.9	10.7	9.9	11.1	9.3
Taiwan	6.1	1.8	2.2	2.3	2.3	2.6	0.3
Korea	4.9	1.2	1.3	2.6	2.9	3.2	6.7
Hong Kong	10.2	7.3	6.7	4.9	7.0	6.8	2.1
Indonesia	5.4	4.0	3.4	6.5	7.8	5.3	-0.5
Malaysia	12.9	10.1	7.1	6.2	6.4	5.8	4.8
Philippines	**2.8**	**2.5**	**2.6**	**2.2**	**1.9**	**1.4**	**2.2**
Thailand	8.9	3.6	2.2	3.1	2.9	4.3	9.0
China	25.1	55.3	55.0	53.5	50.6	50.4	58.8
India	0.3	1.1	1.6	3.2	3.1	3.8	2.9
Vietnam	1.1	2.0	2.4	3.0	3.1	3.4	2.5

***Source: World Investment Report*, 1999**

The deregulation of the industry created an environment conducive to growth and investments. New players entered, thus promoting greater competition in the industry. Firms expanded their networks and introduced new technologies and services. All of these resulted in a sharp increase in investments in the industry, and in the number of service providers and users (Austria 2000a).

Maritime industry. The country is also aiming to be a maritime power in the Asia-Pacific region. The landmark for reform came with the passing of EO No. 185 in 1994, which liberalized the rules governing the entry of new operators for existing routes, deregulated the entry of newly acquired vessels into routes already served by franchised operators, and allowed the re-routing of existing vessels. More reforms provided for the deregulation of domestic shipping rates and accelerated the demonopolization and privatization of government ports nationwide.

The reforms have generated strong competition through the provision of a wide variety of choices for consumers at cheaper rates. In 1996, three shipping lines modernized their fleets and formed a consortium in anticipation of the competition from new entrants into the industry.

Civil aviation. The landmark reform came in 1995 with the passage of EO 219, establishing the international and domestic liberalization policy of the country. For domestic air transportation, restrictions on domestic routes and frequencies were eliminated, including government controls on airfares and charges. For the international air transportation, the EO allows at least two international carriers to be designated as official carriers for the country.

Austria's study (2000b) shows that liberalization and deregulation have brought genuine competition in the domestic air transport industry, resulting in lower airfare, improvement in the quality of service, and efficiency in the industry in general. The international air transport industry, however, has yet to be

liberalized, that is, provisions of EO 219 concerning the industry have yet to be implemented. While other countries are adopting more flexible approaches to liberalization and regulation to meet the increasing demand for international air services brought about by the increasing integration of economies, the country is keeping to its old restrictive practices and policies.

Energy. The energy sector has been subject to several reforms to enable it to meet growing energy demands. In the electricity sector, the implementation of EO 215 in 1993 allowed the private sector (including 100 percent foreign operators) to invest in power-generating projects through the build-operate-transfer schemes. Recently approved was the Omnibus Power Industry Bill, which defines the organization of the electric power industry, outlines the transition phases, and defines the responsibilities of the various government agencies and the private sector.

The deregulation of the downstream petroleum industry under RA No. 8180 in 1997 enabled more suppliers and market-driven pricing of petroleum products.

Water. The Metropolitan Waterworks and Sewerage System (MWSS) was privatized in 1997 with the issuance of Executive Order No. 311.

PARTICIPATION IN MULTILATERAL AND REGIONAL TRADING ARRANGEMENTS

The country's commitment to greater trade liberalization and the opening up of the economy in response to globalization and the growing integration of economies is further manifested in its membership and commitments in multilateral and regional trading arrangements in the 1990s. As discussed below, the country's regional and multilateral commitments complements well the country's unilateral liberalization objectives.

Commitments to the World Trade Organization (WTO)

The Philippines' accession to the WTO was ratified by the Senate in December 1994. With a few exceptions, the country did not reduce tariffs from its unilateral commitments. However, among other things, the country did commit to the following:

- To bind tariff rates at a ceiling rate of 10 percentage points above the 1995 applied rate on some 2,800 industrial tariff lines and 744 agricultural tariff lines representing 63 percent of total tariff lines;
- To convert all existing quantitative restrictions on agricultural imports to tariff equivalents (except rice for which a 10-year delay was agreed upon);
- To bind all current restrictions on market access in the following services sectors: financial services (banking, securities, and insurance); communications (courier services and value-added telecommunications); transport services (maritime, road, rail, and air); and tourism.
- On the Information Technology Agreement, the country committed itself to bind to zero the tariff rates of some 188 IT product lines by 2000 and 47 IT product lines by 2005.

The country subscribed to the full and faithful implementation of its commitments to the WTO within the agreed timeframes (WTO 1999). In 1996, RA No. 8178 was enacted authorizing the replacement of all quantitative restrictions on agricultural products with tariffs. The country also actively participates in the ongoing harmonization work on rules of origin and sanitary and phytosanitary measures. On customs valuation, RA No. 8181 was also passed authorizing the shift from home consumption value to transaction value by the year 2000. On intellectual property rights, RA No. 8293 was passed in 1997, providing for the compliance of the country with the Trade Related Intellectual Property (TRIP) Agreement. As discussed in the preceding section of the paper, the country has made substantial progress in implementing reforms in the services sector.

Commitments to the Asia-Pacific Economic Cooperation (APEC)

The long-term goal of APEC, as set out in Bogor, is to achieve free and open trade and investment in the Asia-Pacific region by 2010 for developed member economies, and 2020 for developing member economies like the Philippines.

The Philippines' commitments to APEC are consistent with its commitments to WTO and AFTA. On tariff, the commitment is to gradually phase down tariffs, targeting a uniform rate of 5 percent, except for sensitive agricultural products, by 2004. This is considerably more liberal and immediate than the country's WTO commitment to bind tariffs at their 1995 levels.

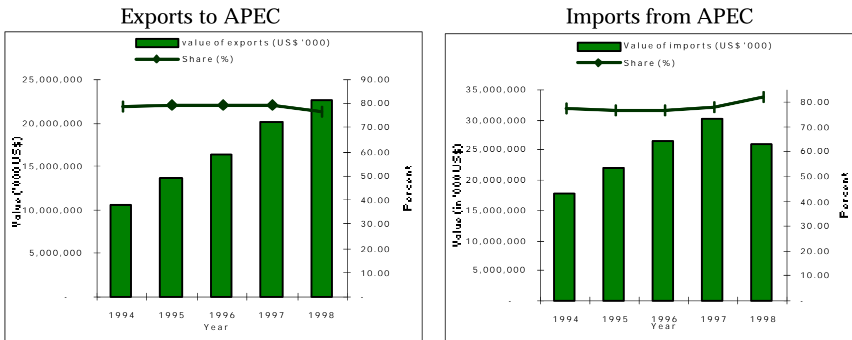
On investment, based on the 1999 Philippine Individual Action Plan, the country has already complied with seven of the 12 *APEC Non-Binding Investment Principles*[2] (Austria 2000c). The seven principles include transparency, nondiscrimination between sources, investment incentives, expropriation and compensation, repatriation and convertibility, settlement of disputes and avoidance of double taxation. The country still imposes restrictions on the principle on national treatment (i.e., the restrictions are contained in the country's negative list for FDI, as discussed earlier). For the principle on performance requirements, the country committed to a temporary exception with a definite timetable that matches the WTO deadline. The compliance with the remaining principles (entry and sojourn of personnel, investor behavior, and removal of barriers to capital exports) is subject to existing laws and administrative regulations.

The country's commitments in the services sector are also beyond the WTO's General Agreement on Trade in Services (GATS). Again, progress in the implementation of commitments on services has been discussed in the preceding section of the paper.

[2] The APEC Non-Binding Investment Principles are APEC's principles for strengthening the efficiency in investment administration, eliminating investment obstacles and establishing a free and open investment environment in the region.

APEC plays a major role in Philippine trade, since the country's major trading partners (USA and Japan and, recently, the ASEAN) are also members of APEC. More than three-fourths of the country's exports and imports occur in APEC, and this has been growing significantly since the 1990s (Figure 2).

Figure 2. Philippine trade in APEC, 1994-1998



Source: PC-TAS

Commitments to the ASEAN Free Trade Area (AFTA)

The Philippines is one of the six original ASEAN signatories to AFTA when it was established in 1992. The objective of AFTA is to increase ASEAN's competitive edge as a production base for the world market (ASEAN Secretariat 1993). The mechanism for achieving this is through the Common Effective Preferential Tariff (CEPT) scheme, where intraregional tariffs will be reduced to 0-5 percent within a 15-year time period beginning in 1993.

Over the years, however, AFTA has taken significant leaps toward its goal (Austria and Avila 2000). First, the deadline has been continuously accelerated from the original date of 2008 to 2003 and finally 2002 (with later implementation dates for its newer members: Vietnam, Burma, Laos and Cambodia). Second, the coverage of the CEPT has been widened by including into the scheme products that were originally excluded (e.g., unprocessed agricultural products). Third, AFTA has also widened its scope beyond the CEPT scheme by including other measures to complement and supplement the removal of tariffs and other border barriers. These initiatives include

harmonization of standards, reciprocal recognition of tests, and certification of products and removal of barriers to foreign investment, among others. Finally, and the most important, AFTA's original goal of 0-5 percent ending tariff rates was deepened by targeting a zero ending tariff rates on all products by 2010 for the original six members, ahead of the original schedule of 2015; and by 2015 for the four new members, ahead of the original date of 2018.

Considering that AFTA's timetable for zero tariffs is 10 years earlier than the country's APEC timetable of 2020, AFTA's liberalization process is definitely a great opportunity for the country to manage its trade reforms more effectively as it prepares for its eventual integration into a bigger liberalized economic space that is APEC.

As a result of the integration of more products into the CEPT, the country's inclusion list has substantially expanded since the inception of CEPT in 1993 (Table 9). By 2001, almost 99 percent of the country's tariff lines will be included into the scheme. The country's average CEPT rate is now down to 4.97 percent and will be further reduced to 4.07 percent in 2002, the deadline for CEPT (Table 10). Nonetheless, the country's CEPT rates are above the ASEAN average.

Table 9. CEPT product list, Philippines, 1993-1999

Year	Inclusion list	Temporary exclusion list	General exception list	Sensitive list	Total
1993	4,451	714	28	-	5,193
1996	4,694	562	28	-	5,284
1998	5,202	380	28	71	5,681
2000	5,571	35	27	62	5,695
2001	5,622	6	16	50	5,694
Percent distribution					
1993	85.7	13.7	0.5	-	
1996	88.8	10.6	0.5	-	
1998	91.6	6.7	0.5	1.2	
2000	97.8	0.6	0.5	1.1	
2001	98.7	0.1	0.3	0.9	

Source: *AFTA Reader*, 1996 and 1998; *ASEAN Annual Report*, 1999-2000; ASEAN Secretariat

Table 10. Average CEPT tariff rates, by country, 1998-2003 (%)

Country	1998	1999	2000	2001	2002	2003
Brunei Darussalam	1.35	1.30	1.26	1.17	0.96	0.96
Cambodia	-	-	10.40	10.40	8.93	7.96
Indonesia	6.12	5.29	4.77	4.36	3.73	2.16
Laos	5.00	5.00	7.07	6.58	6.15	5.66
Malaysia	3.40	3.00	2.85	2.59	2.45	2.07
Myanmar	4.47	4.45	4.38	3.32	3.31	3.19
Philippines	**7.43**	**6.54**	**4.97**	**4.17**	**4.07**	**3.77**
Singapore	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	10.56	9.75	6.07	5.59	5.17	4.63
Vietnam	3.92	3.90	7.09	-	-	-
ASEAN	5.05	4.59	3.74	3.54	3.17	2.63

***Sources: AFTA Reader*, 1998; *ASEAN Annual Report*, 1999-2000**

Two issues confront the country, however. First, during the ASEAN Summit in 1998, the original six members of AFTA were required to have at least 85 percent of their products in their Inclusion List to have 0 to 5 percent tariff rates by 2000. This proportion would then be expanded to at least 90 percent by 2001. As shown in Table 11, however, only 52.5 percent of the country's products are within the 0 to 5 percent tariff band. Second, the new goal of zero tariffs on all products by 2010 requires, as a first step toward the goal, that the original six members would eliminate tariffs on 60 percent of their product lines by 2003. However, the country's current schedule shows that only 1.4 percent of the country's products will have zero tariffs by 2003, in stark contrast to the other ASEAN members, except Thailand whose schedule is similar to the Philippines' (Table 12). This could become a real concern for the country. Given the huge gap between where the country is now and the goal to be reached by 2003, the country would need to do substantial work if it were to meet the 60 percent target by 2003 (Teh 1999).

Table 11. CEPT tariff structure, Philippines, 2000.

Rates	No. of tariff lines	% Distribution
0-5%	2,958	52.5
6-9%	107	1.9
10-12%	863	15.3
13-17%	355	6.3
18-20%	882	15.6
Above 20%	473	8.4
Total	5,638	100.0

Source: ASEAN Secretariat

Table 12. Number of tariff lines in the inclusion list scheduled to have 0% tariffs in the Year 2003

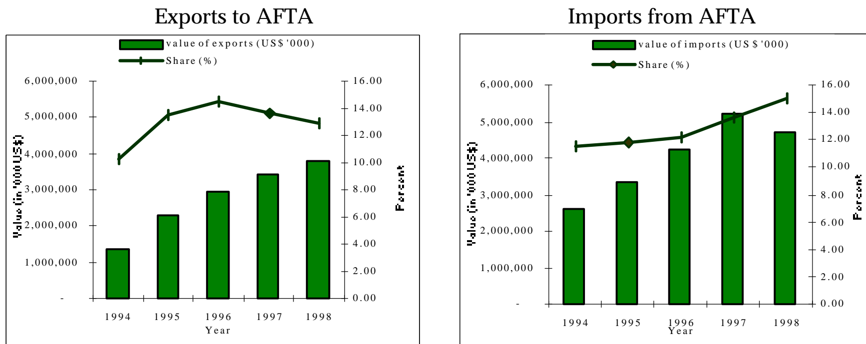
Country	Number of tariff lines				Percentage of inclusion list			
	0	>0	Other	Total	0	>0	Other	Total
Brunei Darussalam	5,071	1,146	12	6,229	81.4	18.4	0.2	100.0
Indonesia	3,897	3,261	-	7,158	54.4	45.6	-	100.0
Malaysia	4,887	3,587	385	8,859	55.2	40.5	4.3	100.0
Philippines	**76**	**5,530**	-	**5,606**	**1.4**	**98.6**	-	**100.0**
Singapore	5,739	-	-	5,739	100.0	-	-	100.0
Thailand	171	8,895	-	9,066	1.9	98.1	-	100.0
Total	19,841	22,419	397	42,657	46.5	52.6	0.9	100.0

Source: Teh (2000)

Philippine trade is rapidly being integrated with the ASEAN. This could be seen from the rising share of the ASEAN in Philippine exports and imports, except in 1997 and 1998 when the share of the ASEAN in the country's exports went down because of the financial crisis in the region (Figure 3). AFTA is contributing to this rapid integration as the share of CEPT products in Philippine trade to the ASEAN has been significantly increasing since 1993 (Austria, 1997).

Nonetheless, the share of the Philippines in total intra-ASEAN exports is the second smallest among the original AFTA members (Table 13). However, its annual growth rate is among the highest. Even during the crisis in 1997-1998, exports of the country to the region grew at 11.2 percent, in contrast to the large fall in intra-regional exports of the other members (Table 14). In 1999, when there was a surge in intra-ASEAN exports, the country registered one of the highest growth rates at 30.5 percent.

Figure 3. Philippine trade in AFTA, 1994-1998



Source: PC-TAS

Table 13. Percent distribution of intra-ASEAN exports, 1993-1999 (%)

Country	1993	1994	1995	1996	1997	1998	1999
Brunei	1.1	0.8	0.8	0.6	0.6	0.3	0.5
Indonesia	11.4	10.0	9.2	10.3	10.2	13.5	11.0
Malaysia	30.0	26.2	26.4	28.3	26.8	31.3	29.4
Philippines	**1.8**	**2.4**	**3.4**	**3.7**	**4.0**	**5.5**	**6.7**
Singapore	41.7	46.8	45.0	42.4	41.0	37.8	39.4
Thailand	13.9	13.7	15.2	14.6	15.3	11.5	13.0
Vietnam					2.1		
ASEAN	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: ASEAN Secretariat website (http://www.aseansec.org.sg).

Table 14. Annual growth rate of intra-ASEAN exports, 1993-1999 (%)

Country	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Brunei	-3.9	13.1	-15.7	11.2	-55.5	69.9
Indonesia	17.5	9.8	28.8	6.6	5.6	-11.6
Malaysia	17.3	20.8	23.4	2.2	-6.9	1.3
Philippines	**79.2**	**65.4**	**26.0**	**15.7**	**11.2**	**30.5**
Singapore	50.8	15.2	8.4	4.1	-26.4	12.6
Thailand	33.0	32.8	10.4	12.6	-39.8	21.8
Vietnam				-24.6		
ASEAN	34.4	19.7	14.9	4.7	-18.5	8.0

Source: ASEAN Secretariat website (http://www.aseansec.org.sg)

EXPANDING AND DEEPENING PARTICIPATION IN REGIONAL INTEGRATION

The challenge now facing the country is how to respond to the proliferation of regional trading arrangements (RTAs) beyond its

current participation in AFTA and APEC. The reasons for the rise of regionalism have been greatly discussed in the literature (see Bhagwati 1994; Baldwin 1997; Either 1998; Krueger 1999). During the past decade, there have been efforts to expand RTAs to include more members into their fold. In fact, the new wave of economic integration has moved beyond the regional level to become inter-regional and even hemispheric (e.g., EU-MERCOSUR, ANDEAN-MERCOSUR, EU-Chile) (Onguglo and Cernat 2000). The ASEAN itself is looking at the prospect of closer economic linkage with Australia and New Zealand. Also, discussions on the formation of free trade areas by individual ASEAN members with other countries or RTAs are in progress, such as the Singapore-New Zealand Free Trade Area and the Singapore-NAFTA linkage.

Likewise, while regional trading arrangements are generally classified either as free trade areas, custom unions, common markets or economic unions, the new RTAs contain elements of more than one of these forms, making economic integration deeper (Krueger 1999). The increasing trend toward the deepening of integration and the expansion to interregional integration creates pressures for inclusion of nonmembers and the Philippines is not exempted.

Expanding regional integration

The Philippines needs to expand and deepen its regional integration for several reasons. One, expanding regional integration provides an avenue for the country to overcome barriers to trade beyond what it can achieve within the multilateral framework of the WTO. This is particularly true for specific sectors that are of particular export interest to the Philippines like garments.

Also, as the last decade has shown, new forms of barriers to trade are emerging. For example, sanitary and phytosanitary measures, rules of origin, and other importing country regulations have been increasingly taking center stage in recent years. The diverse standards and technical regulations among developed countries, along with the corresponding testing procedures for compliance, limit market access and raise production and testing

costs for the country. Likewise, rules of origin have made it harder for nonmembers to trade with members of RTAs.

The emerging trade barriers are less transparent than tariffs and hence, much more difficult to deal with. While some of these areas are also in the WTO agenda, current efforts in dealing with them are slow in coming. In contrast, RTAs advance liberalization in these areas much more rapidly than in the WTO.

Two, expanding regional integration increases the country's competitiveness, enabling it to compete better in the global economy. Considering that the country is too small to carry any weight in influencing the international flow of trade and investments, it needs to continuously improve its competitive strength for its exports and its attractiveness to FDI through regional integration. The proliferation of RTAs has brought many new competitors for the country, both for its export markets and FDI. The potential competitors include countries in the ANDEAN Community and MERCOSUR in Latin America, the emerging economies in Central and Eastern Europe, which are being slowly integrated with the EU through bilateral free trade agreements, and China in Northeast Asia. These countries have the same primary export markets and sources of FDI as the Philippines, namely, the United States, Japan, and the EU. They have also become the new sources of cheap labor. Hence, the Philippines will be faced with discriminatory deals from any regional trading arrangements of these countries with the country's major trading partners.

Finally, the rapid integration of the world has given birth to global concerns that could only be effectively addressed through stronger regional cooperation. One such concern is the growth of organized transnational crimes, like trafficking in illegal drugs and in human beings and the spread of diseases (Severino 2000). The financial crisis has also made all too clear the need to strengthen institutions and improve governance, not only domestically but also across countries and regions. No one country can address these concerns by going it alone.

Beyond AFTA and APEC

The Philippines has two alternative approaches to responding to the challenge of expanding its integration with other countries or RTAs. The country can respond either bilaterally on its own or collectively with the ASEAN or APEC. Considering, however, that the country is too small to carry any weight in influencing the flow of international trade and investment, it would have greater leverage and bargaining options if it were to respond and operate collectively either with the ASEAN or with APEC. After all, as Vejjajiva (200) has argued, "the ASEAN must recognize that no member country is as strong individually as they are together."

Either approach, however, requires that the country's expansion for regional integration be consistent with the WTO rules. What this means is that the integration must be consistent with Article XXIV of GATT and Article V of GATS[3] . The ground rules under these two articles, however, suffer from systemic issues rendering them less effective in imposing discipline (see Crawford and Laird (2000) for a discussion of the systemic issues).

Likewise, the integration must be consistent with APEC and AFTA for it not to undermine the credibility of the country's commitments to these RTAs. For the integration to contribute to global liberalization, it should call for commitments that are beyond current commitments in AFTA and APEC. What this means is that since the country is aiming for a free trade area by 2015 under AFTA and by 2020 under APEC, its expansion for regional integration cannot be less than a free trade area with a timeframe no longer than APEC's or AFTA's.

[3] The conditions for the formation of RTA under Article XXIV include (1) the establishment of a free trade area among members within a reasonable period of time; (2) the reduction of tariffs to zero and the elimination of other restrictive regulations on substantially all trade between the participants; and (3) not raising the duties and other regulations to third countries. On the other hand, the conditions under Article V of GATS include (1) substantial sector coverage (in terms of number of sectors, volume of trade affected, and modes of supply with no *a priori* exclusion of any modes); and (2) absence or elimination of substantially all forms of discrimination through elimination of existing discriminating measures and/or prohibition of new or more discriminatory measures (Onguglo 2000).

To date, the most feasible new regional trading arrangement for the Philippines is under the umbrella of a free trade area between AFTA and the Australia-New Zealand Closer Economic Relations (CER), or simply an AFTA-CER Free Trade Area. Last year, AFTA and CER agreed to look into taking economic integration a step further through a regional trade agreement between the two regions. A task force was then established to explore its feasibility. According to a Center for International Economics study (2000), a free-trade area between AFTA and CER, with zero tariffs on goods and services, will result in a gain of US$48.1 billion of GDP (in net present value terms) over the periods 2000 and 2020. From this amount, AFTA will gain US$25.6 billion and US$22.5 billion for CER.

According to the same study, the GDP gain for the Philippines would be 0.32 percent above what might otherwise be by 2010. In terms of real household consumption, the gain is 1 to 2 percent above what it might otherwise be by 2005. Current trade between CER and the Philippines is still small. CER accounted for less than 1 percent and 3 percent of Philippine exports and imports, respectively, during the period 1994-1998 (Table 15). Nonetheless, this is expected to grow with an AFTA-CER free trade area.

Table 15. Philippine trade with selected RTAs, 1994-1998

Groupings	Exports					Imports				
	1994	1995	1996	1997	1998	1994	1995	1996	1997	1998
Value (in million US$)										
CER	154	164	181	225	185	776	976	1059	1362	894
ASEAN Plus Three	2440	3291	4370	4913	5086	7067	8395	10128	11223	9990
ANDEAN	3	11	12	11	20	54	55	45	64	18
Share in Philippine trade (%)										
CER	1.15	0.95	0.88	0.89	0.63	3.41	3.42	3.05	3.53	2.84
ASEAN Plus Three	18.34	19.16	21.27	19.47	17.24	31.08	29.47	29.19	29.09	31.68
ANDEAN	0.02	0.06	0.06	0.04	0.07	0.24	0.19	0.13	0.17	0.06

Source: PC-TAS

Of increasing importance to the ASEAN since last year is its linkage with its Northeast Asian neighbors—Japan, China and South Korea. The ASEAN Plus Three is a strategy for the ASEAN and Northeast Asian countries to forge deeper cooperation as a regional group in dealing with international and regional economic

fora such as the WTO, APEC and ASEM. Philippine trade with the three countries has been increasing, except during the financial crisis (Table 15). There is a bright prospect for the Philippines with the deeper integration of the ASEAN with the three countries—Japan being a major export market and source of FDI for the country and South Korea being an important source of the country's FDI in recent years.

More recently, the ASEAN has formed linkage with the ANDEAN Community (Bolivia, Colombia, Ecuador, Peru, and Venezuela). Philippine trade with the ANDEAN community is very small (Table 15). The same is true with the trade of the whole ASEAN region with the ANDEAN. Nonetheless, given the more advanced integration process of the ANDEAN (i.e., the community is already a free trade area and is now moving toward a common market), the ASEAN can learn from the achievements and experiences of the ANDEAN. Since the relationship between the two regions is just in its infant stage, there are potentials for greater trade and investment as information is shared. The potential for forging deeper integration between the two regions lies in their direct economic links with the larger APEC region (i.e., the ANDEAN is linked with the members of APEC (Canada, USA, Mexico, Chile and Peru) through the Free Trade Area of the Americas (FTAA) while AFTA is a subregion of APEC (Austria and Avila 2000).

SUMMARY AND CONCLUSION

The Philippines has undergone substantial reforms at opening up the economy during the past two decades. The country's experience points to the importance of domestic policies that foster domestic efficiency and competitiveness before one can participate in regional and multilateral integration and face global competition. The country first pursued trade and investment liberalization policies in the 1980s and 1990s to eliminate the inefficiency of domestic industries arising from its past protectionist regime. The unilateral efforts resulted in better allocation of resources and improvement in the overall competitiveness of domestic industries.

The improved competitiveness enabled the country to participate in the 1990s in regional trading arrangements, such as AFTA and APEC, and in multilateral arrangements like the WTO.

The challenge facing the economy now is how to improve further its competitiveness so that it can deepen and expand its economic integration. It is now widely accepted that globalization is irreversible and is here to stay. While substantial progress has been achieved in liberalizing the economy, much still needs to be done, especially in the agriculture sector.

Likewise, other pressing concerns need to be addressed to allow the country to reap the full gains from economic integration. One of these concerns lies in the area of competition policy. Liberal trade and investment policies are a key element of competition policy, as they eliminate barriers to trade and investment. However, as barriers to trade and investment are eliminated, the business practices and behavior of firms are increasingly becoming more important in fostering efficiency in the economy, more so with the current mergers and acquisitions of multinational companies as a result of globalization. Likewise, there are government policies and regulations that limit competition and hence efficiency. This is particularly true in the services sector (like civil aviation, shipping, power, telecommunications and energy). Given their nature and cost structures, these industries are naturally oligopolistic, and therefore efficiency could only be attained if there are only few large firms in the industry. However, although deregulation and liberalization have been introduced gradually in the sectors, a competition policy has yet to be defined that would govern the behavior of industry players to ensure that they do not behave collusively and exploit their market power. Hence, it is to the best interest of the country to complement its liberalization efforts with appropriate competition policy to further improve its global competitiveness.

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Appendix Table 1. Frequency distribution of tariff rates, 1996-2000

Tariff rate (%)	Number of tariff lines				
	1996	1997	1998	1999	2000
0	-	-	11	158	319
3	2,242	2,295	2,875	2,760	2,703
5	12	13	63	51	111
7	10	10	40	107	579
10	832	1,295	789	856	947
15	-	-	453	353	407
20	1,114	1,129	758	880	464
25	1	1	462	294	-
30	1,349	840	51	43	61
35	1	4	1	2	2
40	32	30	29	30	11
45	-	36	28	30	30
50	47	23	12	20	18
55	-	-	-	1	1
60	13	1	3	46	46
65	-	10	10	7	7
70	1	-	-	-	-
75	-	-	-	-	-
80	10	57	53	-	-
100	57	-	-	-	-
Specific duties	4	4	-	-	-
Total	5,725	5,748	5,638	5,638	5,706

Source: Tariff Commission