

## **APEC AND ECONOMIC LIBERALIZATION IN THE PHILIPPINES**

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The author raises a number of issues related to the Philippines' participation in APEC. First is the issue of whether the country's economic interests are consistent with the objectives of APEC. The author surveys the policy goals and current initiatives towards economic liberalization in the country and notes the "attitudinal shift" among business leaders, both of which appear to be consistent with the APEC vision of creating a free and open trade and investment regime in the Asia-Pacific region. The second issue addressed is whether the country needs APEC. Finally, the author presents some of the expectations as well as apprehensions of a developing country like the Philippines, given the requirements of membership in APEC.

### **1. Introduction**

Without doubt the economic prosperity of the Philippines is inextricably linked with that of the Asia Pacific region. In the first quarter of 1995, it accounted for close to three fourths of the Philippines' total trade and 70 percent of her foreign direct investment (FDI) flows. The Philippines is strategically located in this region which includes the world's strongest economic powerhouses, presently providing much of the impetus to global economic activity. On the other hand, the country — like a number of APEC-member economies — already belongs to a free trade area. It is thus committed to attain full tariff liberalization within ASEAN by year 2003, much earlier than the target year of the APEC vision. Moreover within ASEAN, subregional

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growth areas (e.g. the East Asian Growth area or the EAGA) are fast emerging with substantial potentials for trade and investment interpenetration, even in the absence of formal commitments and bureaucratic intervention.

Given its traditional linkages with the Asia Pacific countries, what then is the need for the Philippines to belong to a broader regional grouping such as APEC? Is the Philippines in a position to subscribe to the APEC vision? What are the Philippines' expectations, as well as its apprehensions as a developing country, with regard to APEC? It is the objective of the paper to attempt to provide answers to these questions.

In the following section, we discuss recent economic policy changes taking place in the Philippines and the extent to which these are consistent with the APEC vision. This provides a clue to the answer of whether or not the country is ready for APEC. The third section presents official and unofficial views on the country's expectations — as well as its apprehensions — of the current and future thrusts of APEC. In these contexts are discussed a number of areas where APEC can be relevant in helping shape the future of the region and of the world economy.

### **2. The Philippines' Readiness for APEC in the Light of Recent Economic Policy Changes**

The Philippines' experience in the eighties jolted it to the harsh reality that it had already been bypassed by its neighboring economies in the development race. Since 1986, however, winds of liberalization have begun to blow, toppling seemingly untouchable policies and practices that have straight-jacketed the Philippine economy during most of its postwar history. In the following subsections, we outline a number of major policy changes that have been undertaken, their short-run impact on private sector perceptions as well as on the economy, and the extent to which they are consistent with the APEC vision.

## *2.1 Trade Policy Reform*

For more than three decades after the war, the protracted application of import-substitution policy stifled competitive pressures on domestic industries. Thus shielded from imports and even from the discipline of inter-firm competition, manufacturing industries, after going through the easy phase of import substitution, remained inefficient and shallow, with little enthusiasm to innovate or adopt international best practice. There was none of the export-oriented frenzy that characterized the development process of the Asian Newly-Industrializing Economies (NIEs) and near-NIEs. Under pressure from multilateral organizations, the Philippines dutifully complied by adopting a tariff reform policy in the early eighties, but this was subsequently aborted at the onset of the economic crisis of 1983-85.

However, the new-found lease on life after the People Power Revolution of 1986 brought to the fore the crucial importance of trade liberalization. The tariff reform policy (TRP) was put back on track. By 1988, the effective protection rate average (EPR) in the manufacturing sector went down to 28 percent, from a high of 43 percent in 1983. Inter-industry variation in effective protection was also reduced. The other component of the Trade Policy Reform, namely the Import Liberalization Program (ILP), dismantled non-tariff barriers. By 1988, 11 percent of all import items remained regulated, in contrast to 33 percent in 1983. A second phase of the ILP followed, bringing down the number of regulated items to 4.4 percent of total tariff lines by 1994.

Another revision of the tariff code was undertaken (E.O. 470) in 1991, designed to reduce average nominal tariffs to 24 percent and average EPR of importable manufactures from 49 percent in 1991 to 39 percent by 1995. Again, there was considerable narrowing down of EPR dispersion for all importables. Another round of tariff revisions is scheduled after 1995 (E.O. 264) that will lower all nominal tariffs on outputs to 10 percent and on inputs



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to 3 percent by 2003. The ultimate objective is to bring down all tariffs to a uniform rate of 5 percent by year 2004, available on a most favored nation (MFN) basis.

Undoubtedly such drastic policy moves had been influenced by the Philippines' commitments to AFTA and subsequently to the Uruguay Round-World Trade Organization (UR-WTO). The global trend towards liberalization seemed inevitable and the only logical response left appeared to be that of aligning all policy moves to such a trend.

The profound implications of such policy reform were not lost on the manufacturing sector. In a 1994 survey of top executives of leading enterprises in the country,<sup>1</sup> 90 percent of respondents were in favor of accelerating the tariff reduction program. Even traditionally domestic-market oriented industrialists can now be heard boasting of going from "local to global." The protectionist "Buy Filipino" slogan has now been replaced by "*world class competitiveness*" and managers are now vying for the coveted ISO 9000 seal of excellence. Import-dependent assemblers, previously forced to export during the foreign exchange crunch of the early eighties, are now gearing up for a share of the expanded ASEAN market and of the seemingly inexhaustible market of Chinese continent. As for policymakers, there seems to be a greater resolve to make the policies stick. An example is the decision not to raise the 10 percent nominal tariff on petrochemical products, in spite of the repeated threats of withdrawal of the interested foreign investor-group if their demand for a 20-30 percent tariff is not granted. And even this 10 percent will have to slide down to the 5 percent uniform tariff by 2004.

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<sup>1</sup> The Management Association of the Philippines' Trade and Industry Committee received 78 responses in a survey that included different sectors of the economy: 18 respondents from the manufacturing sector, 16 from business and professional services, 5 from government service, 4 from agribusiness, one each from mining and the NGO sector and 33 from different services subsectors (CRC, 1995, p.34).

Apart from such anecdotal evidence of an attitudinal shift at the managerial level, as well as greater consistency at the policy level, the underlying economic impact of such trade policy reform has been documented using more objective indicators. Studies (Medalla, Tecson et al., 1995) show that even the partial trade liberalization of the eighties had been accompanied by less concentration and greater efficiency in the manufacturing sector,<sup>2</sup> as well as an improvement in resource allocation as evidenced by the expansion of efficient industries and the contraction of very inefficient ones. Moreover, trade liberalization policy was not found to have inimical effects on small and medium enterprises (SMEs). In fact, SMEs were observed to have increased their share of the manufacturing sector value added and employment in 1988. This was a turnaround from the historical drift towards dominance of the manufacturing sector by large enterprises. In addition, there is micro-level evidence that SMEs net entry into industries in a more liberal environment was a major source of improvement in overall industrial efficiency.

There remain, however, certain areas that have been spared — at least in the meantime — from the fierce winds of liberalization. Hard-core non-tariff barriers (NTBs) have remained in certain products. Particularly worrisome is the agricultural sector that tended to become more protective, even as the manufacturing sector was being liberalized. Fortunately, however, WTO commitments will require tariffication of remaining quantitative restrictions (QRs) with the exception of rice. Thus, although tariff protection on agricultural products will tend to rise (up to a 100 percent rate in the case of some sensitive products such as corn, livestock, poultry), over ten years these rates are scheduled

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<sup>2</sup> Four-plant concentration ratios of (3-digit PSIC) industries went down on the average from 70 percent in 1983 to 63 percent in 1988. Over the same time period, seventy-five percent of (5-digit PSIC) manufacturing industries either maintained/improved their efficiency or reduced their inefficiency levels (based on DRC measure).

to slide down. For agricultural products whose QRs had been tariffied, importation at lower rates will be allowed at volumes equivalent to 3 percent of 1995 domestic consumption. Subsequently the allowable importation will rise to 5 percent by 2004. The Philippines, however, seems not to be alone in agricultural protectionism. Already, there are accusations and counter-accusations of dirty tariffication by UR signatories.

### *2.2 Liberalization in the Service Sector*

Relative to the liberalization that has taken place in commodity trade, the services sector has remained blockaded by protective rules and laws. Nevertheless, even in this area, some amount of liberalization is being undertaken. The country has committed itself under the UR-WTO to a binding of its current restrictions on market access to four services sectors, namely finance, telecommunications, transport, and tourism (CRC, 1994). Some liberalization has taken place in the banking sector: ten foreign banks have been allowed to operate in the country, although the number of branches is still limited to six.

Retail trade has so far remained closed to foreign investments since 1954 with the passage of the Nationalization of Retail Trade Act. However, in the recent State of the Nation Address, President Ramos has specifically identified the need for a repeal of this law to allow foreign competition in the retail trade area. Other sectors that need further liberalization are telecommunications, air transport, and shipping. More and more, their continued protection is being seen as a hindrance to the pace of liberalization taking place in other key sectors of the economy as well as on overall economic growth.

### *2.3 Liberalization of the Foreign Exchange Market and the FDI Regime*

One of the first policy moves of the Ramos administration



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was to allow exporters to hold 100 percent of their export earnings in foreign exchange. This helped boost exports and reduced the incentive to under-declare export earnings. Furthermore, the eventual improvement in the country's credit standing and investment environment encouraged short- and long-term capital inflows, in turn exerting pressure to liberalize the FDI regime.

The passage of the Foreign Investments Act of 1991 (FIA) signaled the country's eagerness to attract FDI, after having been virtually left out by major investors in the region, in particular by Japan after the Plaza Agreement of 1985. Whereas foreign equity had been previously limited to no more than 40 percent of an enterprise's total equity, the FIA allows foreign investors to invest up to 100 percent of capital, provided that the domestic enterprise is exporting at least 60 percent of its output and is not included in the negative lists. Lists A and B refer to industries, products, or services where foreign equity is specifically limited by the Constitution — e.g. mass media or retail trade — or by existing laws. On the other hand, Negative List C "contains investment areas in which existing enterprises already adequately serve the needs of the economy and the consumers and in which foreign investments need not be encouraged further." Presently, however, List C has been left without any entries.<sup>3</sup> Even list B is not untouchable (although List A may require a constitutional amendment), since liberalization of foreign investments in the mining industry has already taken place and that of retail trade might follow.

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<sup>3</sup> Apparently, this was due to an oversight. The Law provides that a Philippine national engaged in an investment area may petition for the area's inclusion in Negative List C. After public hearings and evaluation of the justification, the NEDA (National Economic and Development Authority) may recommend its inclusion. However, the deadline for submission of petitions was allegedly overlooked by potential petitioners.

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While the FIA has substantially eased the rules against foreign equity, there remain other disincentives that have to be addressed. The existence of negative lists, whether due to Constitutional and other legal prohibitions, or what is worse, due to petitions of vested interests, does not project a truly welcoming image to FDI (Alburo, 1993). Moreover, there are incentives to FDI that are offered by neighboring ASEAN countries that are not yet available in the Philippines, such as the net operating loss carryover and the ownership of land.

Nevertheless, the FIA must have given the correct signals to foreign investors, since there has been a rising tide of FDI into the country, and especially into the export-oriented industries. New investments, particularly from East Asia, are flowing into labor-intensive sectors, especially at the higher end of the electrical and electronics industries (such as hard disk drives, ICs, printed circuit boards, plain paper copiers). Interviews of Japanese investors have underlined the main attraction of the country, namely its abundant, highly-trainable work force.

### *2.4 Readiness for APEC*

Given the generally upbeat mood of the economy and the liberalization drive currently being undertaken in many sectors, it appears that the present policy thrust as well as the "attitudinal shift" of the business sector are consistent with the APEC vision. The objective of attaining regional free trade is certainly a "deja vu" after the initially acrimonious debate over AFTA. With tariff rates scheduled to go down to a uniform 5 percent level by 2004 on an MFN basis, an APEC-sponsored initiative for a new round of multilateral trade negotiations to succeed the UR should hold few surprises, at least for the country's manufacturing sector. The agricultural sector will probably be more resistant, as will be the case in most member countries. The attainment of APEC's goal of trade and investment facilitation in the region is certainly in the best interest of the Philippines and is in line with its current policy thrust.



### 3. Does the Philippines Need APEC?

Around the time prior to the First Ministerial Meeting of the APEC in 1989, a senior official of the Philippine foreign service unofficially expressed the initial fear of the Philippines in these words: "We might simply be used as 'pawns' in the battle between the superpowers." It was the time the EC was embarking on the completion of the Single European Market, and the APEC was initially regarded as a knee-jerk reaction to the fear of a Fortress Europe. ASEAN, on the other hand, was in the midst of implementing the Enhanced Preferential Trading Arrangement (PTA) agreed upon in 1987 and it felt threatened by the formation of a wider regional bloc that could dilute the perceived importance of its role in the Asia Pacific (Albuero, 1994).

Since then, however, given the rapid pace of APEC initiatives, the Philippines has shed off most of its initial misgivings over being part of APEC. In fact the current government is an active participant, with senior government officials chairing some working groups and with the preparations underway for hosting next year's APEC summit meeting. A consortium of APEC study groups has already been created, based in the country's major universities and research institutes.

However, there is currently a general lack of awareness on the part of the Filipino public — one would dare say, even among businessmen — of what APEC is all about and especially what its implications are for the country. The Philippine media have so far given scant attention to APEC, proof of a lack of consciousness not only of possible 'threats' but also of the opportunities that APEC might offer. Perhaps the absence of any treaties entered into by government as well as the vagueness of 'deadlines' have helped to relegate APEC to the back-burner of collective consciousness in the Philippines.

On the other hand, among academics, and especially in economic circles, the attitude towards APEC is generally

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one of approval, if not of wholehearted support. Together with the WTO, APEC is looked upon as an external factor "that has to be harnessed as catalyst for promoting the new way of thinking (from protectionism to outward-orientation) and hasten the process of market-oriented reform" (CRC, 1994). Similarly, two well-known economists from the School of Economics of the University of the Philippines, have expressed support for APEC in no uncertain terms:

For the Philippines, there should be no hesitation in supporting any and all of these (objectives of the APEC), including the proposal for regional free trade. The fears that free regional trade under an APEC will supersede AFTA, or will unduly expose the country to foreign competition should be proven unfounded. That is, if the country is confident enough that the pace of internal reform is likely to be faster than the pace of international agreement.<sup>4</sup>

Thus the growing consensus in the Philippines seems to be that in the country's current drive towards greater openness and deregulation, the APEC offers another card — perhaps an ace — in helping shape the government's policy reform agenda, in strengthening government's resolve to pursue it in the face of opposition by interest groups, and in molding the private sector's consciousness of the need for greater competition and market access to achieve efficiency and growth. From recent experience, the debates over the AFTA and later over the ratification of the GATT-UR Agreements brought the major issues to the level of consciousness of the man-in-the-street, and thus broadened the base of support for government to pursue its unilateral trade liberalization agenda.

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<sup>4</sup> De Dios, Emmanuel S. and Albuero, Florian A. (1994), "On Trade and Tariff Policy" *The Unfinished Agenda: A Policy Paper*, Philippine Exporters Confederation, Inc. Manila.

#### 4. Expectations (and Apprehensions) of an APEC Member Country

There remain a number of expectations — as well as apprehensions — from being a member of APEC. First is that the Philippines would like to see APEC become and remain a powerful instrument that will keep global markets open, and especially those of the major players, the US, Japan, and the EU. It had already proven its worth when by its sheer size APEC served as a critical factor to the successful conclusion of the Uruguay Round, a role that ASEAN would never have been able to play (Albuero, 1995). However, there is always the danger — possibly an attraction — for some member countries to try to turn APEC into an exclusive regional bloc that could serve as a countervailing force to other blocs. APEC's continued espousal of the ideal of *open regionalism* (even if some economists consider the term an 'oxymoron') will help it escape from this danger, and prevent the Asia Pacific region from turning in on itself. APEC's role would then be that of setting the pace for greater trade liberalization through a demonstration of the beneficial effects on its member-economies of an open trading system, rather than through the creation of another preferential, and hence, exclusive, trading area.

APEC should thus avoid becoming a discriminatory regional trading bloc, like the NAFTA or the EU. If the objective is to foster freer trade in the region, it should do so in a manner consistent with the ultimate goal of multilateralism, since a multilateral approach is clearly first-best. By working towards a dismantling of trade barriers among member countries, APEC should be aiming at strengthening the WTO and hastening the process towards multilateral liberalization through bolder initiatives. In a sense, the Philippines, by aiming unilaterally at achieving at 5 percent uniform tariff by 2004, is attempting to go ahead of its commitments to WTO, because it believes that it is in its best interest to do so. East Asian countries, with the outward-looking orientation that has always



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characterized their economic policy and which has proven to be a major source of the region's dynamism, should thus exert influence within APEC to chart a nonpreferential, non-exclusivistic approach to the global trading system.

Trade and investment facilitation, as proposed by the Eminent Persons Group (EPG), is thus an important component of the APEC's liberalization drive. Following the experience of the EC, a multitude of administrative measures, such as differences in product standards, customs formalities and charges, etc. among member-countries, turned out to become formidable NTBs that fragmented the European market, even after tariffs had been completely eliminated. There is a real problem of lack of transparency and comparability among member countries that must be addressed if true liberalization is to come about.

A first step to take is to generate information on the existence of country-specific measures that tend to impede trade. This has been attempted by the Committee on Trade and Investment (CTI) as agreed upon at the 1992 Bangkok Ministerial Meeting. To generate such information, the CTI furnished all APEC members with survey forms to identify administrative aspects of market access (AAMA) that serve as impediments to trade. From the submissions of fifteen (15) APEC member countries, a total of 379 notifications were identified in the CTI report. Among other findings, the report shows that the most pervasive AAMA were the existing national and international disciplines and practices; that the top five measures receiving the most number of notifications involved manufactured and industrial goods (specifically in the areas of technical standards, customs formalities, and anti-dumping); that Korea, US, and Japan received the most number of notifications. Unfortunately, however, this Report allegedly did not receive a positive feedback from member countries. But given the kind of information provided by the list of notifications classified by country, the work accomplished by the CTI can be considered a necessary first step in achieving the goal of trade facilitation and should thus be pursued.

In addition to facilitation in merchandise trade, the Philippines expects APEC to undertake initiatives that go beyond the UR agreements in liberalizing market access in services, especially in finance, transport (aviation and shipping) and telecommunications. APEC-wide commitments would have the additional benefit of hastening liberalization of services trade at the domestic level, where interest groups are still quite entrenched.

The other great expectation of the Philippines from APEC is that it will serve as a forum for the coordination of member-country positions on common issues confronting them. As an example of such issues, the Philippines, — and presumably most developing country-members of APEC — is uncomfortable with the proposal of including a Social Clause in the WTO that would link labor standards to trade. This possibly well-intentioned concern for the protection of labor could easily be used as a protectionist device against countries that are most vulnerable, namely the developing ones. As Bhagwati puts it, it can become “blue protectionism ... masking behind a moral face” (Bhagwati, 1995). A similar issue is that of linking trade to environmental standards. In WTO discussions and especially under a new round of negotiations, APEC could very well use its influence to prevent the introduction of such protectionist devices into the world trading system. It is recognized, however, that total consensus over such issues does not exist even among APEC member countries, but at least some amount of convergence in ideas might be more easily reached in discussions involving a smaller number of trading partners.

## 5. Concluding Remarks

The scope for regional cooperation and coordination is as vast as the imagination of member-countries. A number of such areas — harmonization of national product standards and testing procedures, cooperation on macroeconomic and environmental concerns, technical cooperation in human resource and SME-development, development of effective dispute settlement mechanisms — have already been identified

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and expounded upon by the Eminent Persons Group. What is needed is political will and commitment by member country governments, as well as the insistent prodding of the private sector to achieve the goal of true and meaningful economic cooperation in the Asia Pacific region.

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