

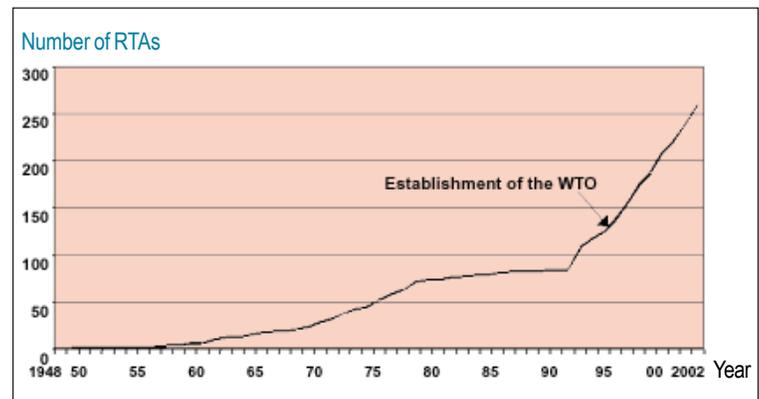
## What's happening in the Philippine free trade agreements?

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The formation of free trade agreements (FTAs), both regional and bilateral, has been a worldwide trend in the past decades. Currently, almost every member of the World Trade Organization (WTO) is a member of at least one such arrangement (if APEC is to be included). If the trend continues, the number of regional trade agreements (RTAs) is expected to reach 300 by 2007<sup>1</sup> (Figure 1).

Along with the increase in number is the growing phenomenon of cross-regional RTAs. New generation FTAs have also evolved with elements encompassing trade facilitation and liberalization, covering a diverse set of agenda and enhancing the features of cooperation.

**Figure 1. Growth of RTAs in the world, 1948-2002**



Source: WTO Secretariat

### **Current state of multilateral negotiations**

#### *What happened in Cancun?*

In September 2003, WTO members met in Cancun, Mexico for the 5th Ministerial Con-

*PIDS Policy Notes* are observations/analyses written by PIDS researchers on certain policy issues. The treatise is holistic in approach and aims to provide useful inputs for decisionmaking.

This *Notes* is an update of developments on free trade agreements (FTAs) as earlier discussed in PIDS Policy Notes No. 2004-09 titled "Exploring the Philippine FTA policy options" by the same authors. The authors are Senior Research Fellow and Research Analyst, respectively, at PIDS. The views expressed are those of the authors and do not necessarily reflect those of PIDS or any of the study's sponsors.

<sup>1</sup> Thirty-three RTAs were notified in the WTO in 2001.

ference to advance the Doha Development Agenda. Unfortunately, the negotiations during said meeting collapsed.

The failure of Cancun has been generally attributed to the collapse of the talks around the Singapore issues, namely, trade and investment, trade and competition policy, transparency in government procurement and trade facilitation. The proposition of uniform policies and procedures to govern cross-border activities in these areas was not acceptable to most developing countries as this would entail supervision or surrender of national prerogative to the WTO. Other issues that contributed to the Cancun breakdown involved agriculture,<sup>2</sup> nonagricultural market access and the cotton subsidy. The discussions in these areas reflect the member states' unwillingness to compromise on focal points, specifically in agriculture.

#### *The July Package*

In the hope of reviving the negotiations, WTO members concluded a "Framework Agreement" on July 31, 2004 which would have restored the confidence in the multilateral trading system and would serve as the basis for continuing negotiations of the Doha Agenda. The decision was mainly concerned with development issues, including provisions for flexibility for developing countries. Notwithstanding this Framework, there remains the concern regarding timeframes and substance. Transparency and commitment likewise remain as crucial as the determination of the modalities of increased market access.

<sup>2</sup> This was complicated by the emergence of the Group of 21 (G-21+), a group of developing country exporters (of which the Philippines is a member), resulting in the shift in agriculture alliances.

<sup>3</sup> One in which a set of integrating units moves through numerous phases in orderly fashion.

Another important consideration is the fact that for a developing country like the Philippines, liberalization of the agricultural sector remains an important, if not the determining, factor in the negotiations. This includes market access, domestic support, and export subsidies. The importance of these pillars of negotiation calls for the position that they should not be tied up with the Singapore issues.

As in the earlier rounds of negotiations, it seems that success is measured in terms of the extent to which negotiators are able to prevent change. These issues need to be clarified and objectives redefined as the repeated failure in the trade talks not only proved to be costly but also demoralizing. The July Package might have brought some high hopes but its success is yet to be seen in the next round, which will be held in Hong Kong in December 2005.

#### **Multilateralism vs. regionalism**

The debacle in the multilateral negotiation has in one way or another contributed to the proliferation of FTAs/RTAs. The question now is whether an RTA is a building or stumbling block to the WTO. In understanding the dynamics of the interplay of these two systems (RTA and WTO), a proper characterization of the concept of regionalism would be helpful. This involves an understanding of whether regional integration is a developmental process<sup>3</sup> or is more haphazard or nonlinear (Choi and Caporaso 2002). In this regard, economists have identified a set of stages of economic integration (Figure 2).

#### *General framework*

There is general consensus that multilateralism is the ideal approach to bring about optimum welfare. It is the setting where both global and individual country's efficient resource allocation is promoted. Multilateral decisions, however, are often more difficult to reach. Furthermore, handicapped with resource, capacity

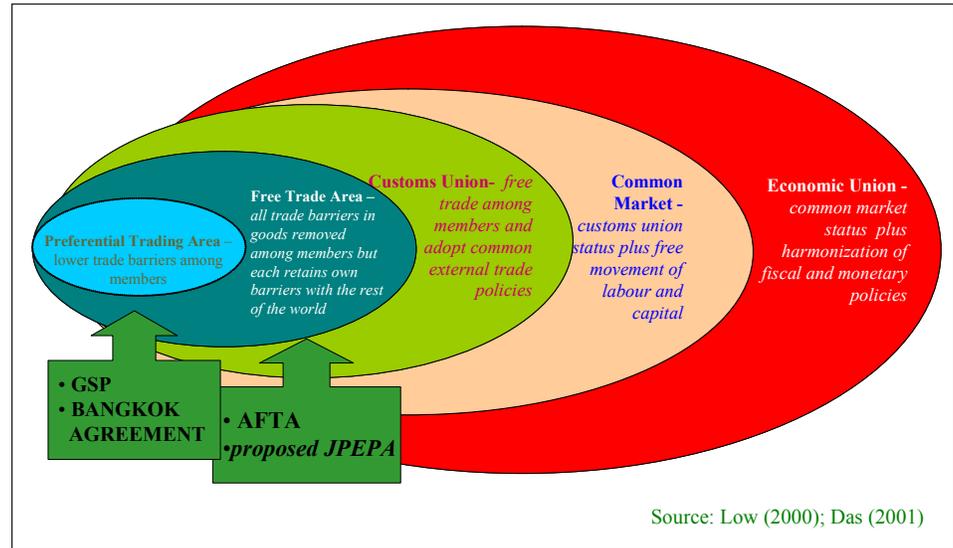
and capability constraints, developing countries are often unable to actively (and pro-actively) negotiate and bring to the table the concerns which are most vital to them.<sup>4</sup> These have thus prompted many countries to engage in a regional and bilateral approach.

For most of these countries, there are practical and possibly compelling reasons for pursuing the preferential approach. Among these are:

- *As a testing ground.* Although there are long-run benefits to liberalization, there are unavoidable short-run adjustment costs which make it very difficult to pursue. Regional or bilateral agreement is a less risky channel for promoting the country's needed reforms, e.g., with the demonstration effects that make reforms acceptable and capability building that it could provide.
- *As a step to multilateralism.* As stated earlier, small countries separately do not have the bargaining tools to advance their interests. The success of bilateral cooperation or regional integration unifies and strengthens the region's position in the multilateral WTO.
- *As a defensive mechanism.* There are some potential risks (costs) to a preferential FTA approach. These are in the areas of trade diversion, resource diversion (where government resources are diverted away from multilateral negotiations) and political diversion (which could deplete political capital in doing domes-

<sup>4</sup> Often, there is even lack of understanding on what these vital concerns are.

**Figure 2. Levels of economic integration**



tic reforms). Membership in an FTA by itself is thus seen as a protective shield from the adverse consequences of other (potential and actual) FTAs.

### Current state of regional integration

#### *Formation of blocks*

Economic integration is practically concentrated in three regions, namely, Europe, the Americas and East Asia (which broadly refers to the Asia-Pacific region). While the broad patterns are similar, there are also wide divergences in terms of the institutional basis of associations, scope of activities covered, and the level of institutional authority (Choi and Caporaso 2002).

The European Union (EU) is a comprehensive economic union with activities ranging from trade and investment to agriculture, transport, environment, some aspect of social policy and to economic and monetary union. The North American Free Trade Agreement (NAFTA) in the

Americas, on the other hand, is a preferential trade agreement. Thus, its scope of activity remains largely limited to trade and investment although it has been used as a forum for discussing and implementing standards for labor and the environment (Choi and Caporaso 2002). Efforts are currently being pursued toward the formation of the Free Trade Agreement of the Americas (FTAAs) which would rival that of the EU's economic union. Meanwhile, although East Asia lags far behind in terms of institutionalization, the main focus of RTA activity has shifted away from Europe in the last two years toward Asia Pacific, specifically the East Asian region.

#### *Shift to regional/bilateral FTA approach*

Countries traditionally favoring most favored nation (MFN) liberalization are increasingly being drawn into RTAs. They now see FTAs as complementary to the WTO process. Moreover, issues that usually take time or have a "deadlock" before the multilateral negotiations are brought by them in the RTA forum, as seen below in the examples of Japan and the United States.

**Japan.** Japan has abandoned its "single track" approach to multilateral WTO. Among the reasons are: (1) its growing disenchantment with the GATT/WTO;<sup>5</sup> (2) China's threat to replace Japan as the primary driving force for economic growth and integration in the region; and (3)

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the need for a domestic structural reform catalyst. Japan's FTA initiatives consist of a dual or two-track approach that is negotiating with ASEAN as a whole and bilaterally with individual member countries.

**USA.** On October 26, 2002, President George Bush announced United States' trade initiative with the ASEAN called the Enterprise for ASEAN Initiative (EAI). Under the EIA, the US and individual ASEAN countries will jointly determine if and when they are ready to launch free trade agreement (FTA) negotiations. For the United States, FTA has become an important element of its trade policy, a strategy known as "competitive liberalization." This strategy is designed to simultaneously push trade liberalization forward on the bilateral, regional and multilateral fronts. It is meant to spur trade negotiations by liberalizing trade with countries willing to join FTAs, and to pressure other countries to negotiate multilaterally.<sup>6</sup>

#### *East Asia FTA formation*

It was in the late 1990s when the region saw moves to institutionalize free trade agreements through bilateral FTAs and other initiatives. Now, there is an increasing trend toward an East Asian economic integration. East Asian regionalism appears to be characterized and stimulated more by dynamic developments in markets rather than by formal political institutions, i.e., the convergence of the East Asian market<sup>7</sup> is actually happening even prior to the formal integration phase (Krumm and Kharas 2003). Nonetheless, a need for a formal FTA is

<sup>5</sup> This is due to the breakdown of the WTO ministerial talks in Seattle in December 1999 and the dissatisfaction with the implementation of rules specifically on anti-dumping by some WTO members.

<sup>6</sup> US Congressional Research Service (2003) available at [www.crs.gov](http://www.crs.gov).

<sup>7</sup> An example is the international production sharing scheme which resulted in a remarkable increase and concentration of intraregional trade.

increasingly being felt owing to still fragmented markets within the region characterized by diversity of cultures, and 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<sup>8</sup> would be achieved sooner or later. This is also inevitable owing to the growing sentiment that trade liberalization within the ambit of the WTO and APEC has not been making substantial progress. In addition, China's succession to the WTO, the successful integration of the European region through the European Community (EC); and the impending FTAs, had shaped the growing sentiment for the need to create a "strategic alliance," if only to enable the Asian region to face the current global trading movement.

### Developments of FTAs involving the Philippines

As early as the 1980s and in the face of growing regional integration and global competition, the Philippines' strategy had shifted from a protectionist regime to a relatively open economy. In the pursuit of regional coopera-

tion, it was a party to the establishment of the Asia Pacific Economic Cooperation (APEC) in 1989 as well as the creation of the ASEAN Free Trade Area (AFTA) in 1992. The failure, however, of the two successive rounds in the WTO as well as the rise of Asian bilateralism had prompted the Philippines to jump into the "bandwagon" of forging FTAs. The Philippines then started engaging in formal FTA negotiations, both *bilaterally*, with Japan for an economic partnership agreement, and *interregionally*, for the establishment of the ASEAN-China, ASEAN-Japan and ASEAN-India FTAs. Other prospective FTAs involving the Philippines are the US-ASEAN, ASEAN-Korea and the ASEAN-Australia-New Zealand Closer Economic Relations (aside from other bilateral engagements) arrangements.

#### *Ongoing bilateral FTA negotiations*

On December 4, 2002, Japan's Prime Minister Junichiro Koizumi and the Philippines' President Gloria Macapagal-Arroyo held a meeting in Tokyo during the latter's visit to Japan and discussed the establishment of a Japan-Philippines Economic Partnership (JPEP). Based on the agreement on the basic framework for negotiations in February 2004, the economic partnership agreement (EPA) concluded its 5<sup>th</sup> round of negotiations last November. Negotiations were targeted for conclusion by the end of 2004 and implementation of the EPA is expected in 2005. The envisioned JPEPA has two main objectives—liberalization and facilitation, and economic partnership enhancement as shown in Table 1.

#### *Progress in the ASEAN economic integration*

Within the ASEAN, the overall improvement of the region's investment environment as well as strong regional growth and integration had brought attention to two things: the realization of an ASEAN Economic Community (by 2020) and the pursuit of economic ties with

<sup>8</sup> The concept of a broad East Asian FTA was discussed at the December 2000 ASEAN Plus Three summit to include China, Japan and South Korea. The framework for the East Asia FTA finds its basis from the "Joint Statement on East Asia Cooperation" (Manila 1999). The Statement declared 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. Since then, several ministerial level meetings and two working groups have been organized. In the ASEAN+3 summit, short-term measures like the formation of the East Asia Forum and East Asia Business Council and long-term measures like the formation of the East Asia Free Trade Area and evolution of ASEAN+3 summit to East Asian summit were introduced. The process of the East Asian regionalism has been progressing along two tracks, one being *financial cooperation* and the other toward an *Asian economic community* (Young 2004).

**Table 1. Scope of the Japan-Philippines Economic Partnership Agreement (JPEPA)**

Chapter No	Chapter Title	Domain
—	Preamble	—
1	General provisions	Liberalization and facilitation
2	Trade in goods	
3	Rules of origin	
4	Customs procedure	
5	Paperless trading	
6	Mutual recognition	
7	Trade in services	
8	Investment	
9	Movement of natural person	
10	Intellectual property	
11	Government procurement	
12	Competition	
13	Financial services cooperation	Economic partnership enhancement
14	Information and communications technology	
15	Energy	
16	Science and technology	
17	Human resource development	
18	Trade and investment promotion	
19	Small and medium enterprises	
20	Broadcasting	
21	Tourism	
22	Dispute and avoidance settlement	
23	Final provisions	

the ASEAN's major trading partners through FTAs (Table 2).

As seen in the above, engagement in FTAs is thus becoming a significant trade policy tool for the Philippines. These FTA initiatives basically have a two-fold domain: one is trade facilitation and liberalization, and two is the enhancement of economic relations, at least for economic partnership agreements. These objectives manifest the Philippines' commitment to greater trade liberalization in this era of glo-

balization. With respect to the integration of economies in the bilateral or regional level, these preferential FTAs are seen more as *complements* rather than *threats* to the multi-lateral system of the WTO.

### Conclusion

The foremost consideration in entering into bilateral or regional FTAs should be the Philippines' own national agenda. The country's foreign trade policy with respect to engaging in 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.

There is no single template for an ideal FTA. However, in formulating such, a country (as enunciated in an earlier PIDS Policy Notes — PN No. 2004-09, September 2004) should at least be able to have a clear objective with respect to: (a) the *elements* of an FTA, its substantive contents and institutional framework; (b) the *criteria for choosing a partner* to the FTA; and (c) the assurance that the FTA should be more than a FTA *per se* and more of a mechanism toward achieving a stronger purpose. At the same time, in drafting the country's areas for negotiation and FTA agenda, the country could benefit from the different models of FTAs entered into by the prospective partners. Finally, there should also be an explicit adherence to following consistency with the WTO.

Aside from these traditional FTA issues, attention should also be given to the so-called enhancing features of new age FTAs. 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

**Table 2. Prospective ASEAN+ FTAs**

FTA Partner	Status of Negotiation
China	<ul style="list-style-type: none"> <li>– Signing of Agreement on Services and Dispute Settlement Mechanism in November 2004</li> <li>– Recognition by ASEAN 10 members of China’s “market economy” status on September 4, 2004</li> <li>– FTA establishment by 2010/2015 for ASEAN-6/Cambodia-Laos, Myanmar and Vietnam (CLMV)</li> <li>– Implementation of ASEAN-China FTA for Trade in Goods on January 1, 2005 (Early Harvest Program implemented January 1, 2004 except Philippines)</li> </ul>
Japan	<ul style="list-style-type: none"> <li>– Target conclusion of FTA by April 2007 and implementation by 2012/2017 ASEAN founding/new Members</li> <li>– Formal negotiation by April 2005</li> <li>– Realization of ASEAN-Japan Closer Economic Partnership in 2012</li> </ul>
India	<ul style="list-style-type: none"> <li>– 6th Meeting on ASEAN-India Trade Negotiation Committee in September-October 2004</li> <li>– Implementation of Early Harvest Program on November 1, 2004 with complete tariff elimination by 2007/2010 (ASEAN-6/CMLV)</li> </ul>
CER (Australia and New Zealand)	<ul style="list-style-type: none"> <li>– ASEAN-CER Commemorative Summit in November 2004 (FTA launch)</li> <li>– FTA negotiations to start in 2005</li> </ul>
European Union	<ul style="list-style-type: none"> <li>– Launch of the Trans-Regional Trade Initiative (TREATI)- A New Partnership with South East Asia in July 2003</li> </ul>
South Korea	<ul style="list-style-type: none"> <li>– Completion of the Joint Study on the feasibility of ASEAN-Korea FTA@ Negotiations to commence in 2005</li> <li>– Realization of FTA by 2009</li> </ul>
United States	<ul style="list-style-type: none"> <li>– Enterprise for ASEAN Initiative (EAI) announced on October 2002</li> </ul>

if, in the case of a developing country, provisions on cooperative undertakings, support and assistance in the areas of technology transfer, human resource development, environment, SMEs and infrastructure development are included.

In drafting the Philippine FTA policy, consideration of the following would prove to be useful:

- Intra- and intergovernmental coordination mechanisms for coordinated policy decision-making process;
- Participation of private sector through business advocacy, consultation, observer status in negotiations; and
- Networking of negotiators, academe/experts and business/industry sector as well as civil society.

Finally, 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* where the arrangement can serve as catalysts for development and mechanism 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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