

## Editor's Notes

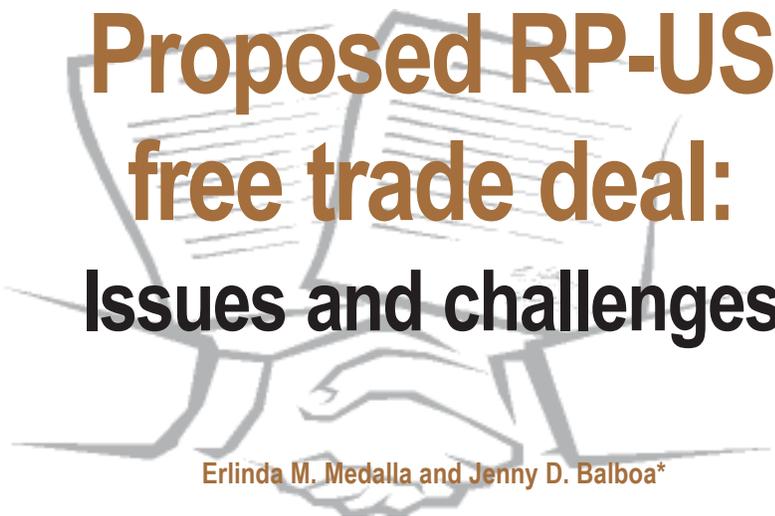
As trade consultations between the Philippines and the US continue, in the hope of cementing a possible free trade agreement (FTA), questions are still afloat on whether the Philippines stands to gain from this deal. (Or perhaps, the better question is whether it stands to lose more if it does not take this opportunity.)

At first glance, the pursuit of an FTA is desirable for the Philippines, what with the increased access to the huge US market that Philippine exports, both goods and services, can enjoy. There are strong trade complementarities between the two countries that are likely to be strengthened with an FTA. Indeed, the positive economic gains are plenty but admittedly, the stakes are also high for the Philippines. Think about the business closures and job displacements that may occur if local industries are not

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# Proposed RP-US free trade deal: Issues and challenges

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**T**remendous technological developments and changing conditions in the world market have led to an increasing regional and global integration, whether as a natural convergence of markets (*de facto* regional integration) or as a consequence of national strategies of countries to formally forge closer economic partnerships (*de jure* regional integration). Indeed, forming free trade agreements (FTAs) and bilateral economic partnerships has become an important policy option for many countries. It is becoming a major instrument for attracting and competing for foreign investments, possibly even more than a mechanism for gaining additional market access. The capital inflows secured from these investments are envisioned not only to generate additional employment but also to bring about improvements in technologies and management skills, free resources to finance development reforms and, in general, fuel economic growth. Moreover, an FTA is also envisaged by

many countries to spur much-needed reforms in domestic markets.

It behooves the Philippines to at least consider the option of forming such trading arrangements. Outside the ASEAN, its first formal attempt is its ongoing negotiation with Japan for an economic partnership agreement. Currently, the Philippines has other prospective partners, perhaps none more important than the United States. The main questions to ask are: What is the potential impact of a Philippines-US FTA? What are the major issues and concerns that we need to know and consider? Should the Philippines enter into a bilateral FTA with the US?

Forging free trade agreements is part of the "competitive liberalization" strategy

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of the US designed to push forward trade liberalization simultaneously on bilateral, regional and multilateral fronts. It is meant to spur bilateral trade negotiations with countries willing to join FTAs, and to pressure other countries to negotiate multilaterally (CRS 2002). This is why the prerequisites for any country wanting to have an FTA with the US are membership in the World Trade Organization (WTO) and a Trade and Investment Framework Agreement (TIFA) with the US. Of the 10 ASEAN countries, seven are members of the WTO and only three have TIFAs with the US, including Thailand and Indonesia.

Currently, the US has free trade agreements in force with the following: Canada and Mexico (North American FTA); El Salvador, Nicaragua, Costa Rica, and Guatemala (Central American FTA); Peru, Ecuador, and Colombia (Andean FTA); Botswana, Lesotho, Namibia, South Africa, and Swaziland (Southern African Customs Union); and Australia, Bahrain, Chile, Israel, Jordan, Morocco, Panama, and Singapore.

Among the ASEAN countries, Singapore was first to sign an FTA with the US on May 6, 2003 following President Bush's announcement for an Enterprise for ASEAN Initiative (EAI). The Agreement officially came into force on January 1, 2004. Thereafter, other ASEAN countries also prepared to negotiate for an FTA with the US. Thailand is currently conducting negotiations with the US. Indonesia and the Philippines are eyed to be next.

Senator Richard Lugar of the United States Congress presented Senate Bill 2004 on March 11, 2002, authorizing the American President to negotiate and conclude an FTA with the Philippines.<sup>1</sup>

<sup>1</sup> From Renato de Castro and Maria Castaños' paper on "Political-strategic dimension of the US proposal for an FTA." Summary on pages 14-15.

The Bill even came ahead of Bush's announcement for an EAI that will pave the way for the US to pursue an FTA with individual ASEAN countries.

Following the EAI launching, the 107<sup>th</sup> US Congress has proposed negotiations for an FTA with the Philippines (CRS 2002). Initial steps have also been undertaken by the US-Philippines Trade and Investment Council to realize a possible RP-US FTA by identifying key areas for cooperation.

#### Status of RP-US economic relations

The US has long been a constant major trading and economic partner of the Philippines. Although US share in Philippine trade has declined somewhat over the years, it still accounted for at least 18 percent of Philippine exports (valued at US \$7 million) and 19 percent of Philippine imports (valued at US\$8 million) in 2004 (*Philippine Statistical Yearbook 2005*).

The US is the main exporter of electrical machinery and equipment, nuclear reactors, boilers and machinery, and other instruments and heavy equipment to the Philippines. Meanwhile, a substantial number of Philippine products enjoy high import shares in the US market, with basketwork manufactures, animal and vegetable oils, and food preparations as main US imports.

In terms of foreign direct investments (FDI), the Philippines is recipient to PhP3.6 billion of FDI from the US. Prior to 2002, the US was the top foreign direct investor in the country. It still belongs to the top three, with Japan and Taiwan occupying first and second places. The US is also a leading destination of overseas filipino workers (OFWs). From 1998 to 2002, some 18,854 OFWs were documented to have worked in the US. Remittances amounting to US\$ 4.18 billion were recorded in 2003 alone. (This total includes remittances from other countries that were coursed through the financial system and that ended up in US banks.) In the past two years, however, the number of OFWs in

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the US declined at -9.7 percent due to the more restrictive entry of foreigners in the US soil.

The Philippine economy, along with the rest of the ASEAN economy, is complementary with the US in a way that trading patterns between the two countries follow the traditional comparative advantage theory. The relatively human capital- and physical capital-abundant US tends to export advanced technology and capital-intensive goods to the Philippines. In turn, relatively labor-abundant countries such as the Philippines export labor-intensive goods and other light manufactures to the US. Given this trading potential and given that both countries have demonstrated a high capacity to work together, the prospects for an RP-US FTA could be worth exploring.

#### Initial assessment of the impacts of a prospective RP-US FTA

A computable general equilibrium (CGE) analysis conducted by Cororaton (2004) shows a small but net positive gain for the economy with an FTA, with a 0.1 percent increase in GDP as Table 1 shows. That the impact is small is not surprising, considering that the average rate of duty is already quite low. Current average tariff rate is 6.82 percent, with 55 percent of Philippine tariff lines clustered around the 0-3 tariff levels, and 29 percent in the 5-10 tariff levels (for details, see Aldaba 2005).

The good sign is that the net effect is positive. This is very significant because the CGE model assumes everything else to be equal, which means that the same total factor endowments are used (the same total level of capital and labor are allocated across sectors). Hence, in effect, with the tariff reform and the FTA, more output is derived from the same total capital resources, suggesting better resource allocation on the whole. This highlights the primary benefit from trade liberalization—the better allocation of resources that it encourages.

**Table 1. Net impact with RP-US FTA (Cororaton 2004)**

Change in prices, %	
Import prices in local currency	-1.5
Consumer prices	-0.1
Local cost of production	0.1
Real exchange rate change, %	0.1
Change in import volume, %	1.5
Change in export volume, %	1.1
Change in domestic production for local sales, %	-0.1
Change in consumption (composite) goods, %	0.2
<b>Change in overall output, %</b>	<b>0.1</b>

By sector, as shown in Table 2, the CGE analysis estimates an incremental 0.5 percent increase for industry, compared to nonfood manufacturing estimated to expand more by an incremental rate (arising from the FTA) of around 1.1 percent. Both the tariff reform and the FTA are also estimated to benefit unskilled non-agricultural labor more than skilled labor.

Even more important to look at is the impact of FTA on poverty reduction. Improvement in factor incomes and reduction in consumer prices have an

**Table 2. Sectoral effects with RP-US FTA (Cororaton 2004)**

	Share (%)	Intensity (%)
Agriculture	6.40	0.08
Industry	59.90	0.21
Non-food manufacturing	48.00	0.35
Services	33.70	0.14
<u>Sectoral output effects</u>		
	Impact of past tariff reform* Without FTA (%)	Incremental impact of FTA (%)
Industry	1.90	0.50
Non-food manufacturing	4.20	1.10
Agriculture	-0.90	1.90
Skilled agricultural labor	-0.20	0.70
Unskilled agricultural labor	1.20	0.70
Skilled non-agricultural labor	1.20	0.70
Unskilled non-agricultural labor	2.60	1.10

\* Refers to tariff reform during the past decade.

impact in reducing poverty. The CGE analysis shows that an RP-US FTA would reduce poverty incidence, especially in the national capital region (NCR) where industries are based. The reduction is highest for the NCR and lowest for the rural sector. But while the CGE analysis shows net potential gains for the Philippines on the whole, the impact will vary across sectors. There is a need, therefore, to look closely at the micro effects of an RP-US FTA.

Among the special interests of the Philippines in the RP-US FTA include greater market access for agricultural goods (e.g., sugar, fresh and canned fruits, etc.). An FTA is seen as an opportunity to eliminate tariffs and quantitative controls, and freedom from US farm programs that have distorting effects on prices.<sup>2</sup>

An FTA is likewise expected to pave the way for preferential access for garments and textile exports to the US market that have been getting tough competition from China's similar exports.<sup>3</sup> Furthermore, bilateral economic partnerships are expected to spur a "forced efficiency" effect that will induce efficiency and productivity gains, and restructure the economy to improve the domestic supply chain (Naya 2005).

Beyond trade gains, the Philippines expects that an FTA will achieve the following:

- Strengthen channels and linkages with the American business sector;
- Improve employment opportunities;
- Help improve dispute settlement on investments which will encourage investors owing to the more explicit rules;
- Advance reforms in domestic economic policies that affect

economic efficiency, economic welfare, and growth;

- Improve the economic image of the Philippines;
- Create more responsive agencies in terms of trade and investment activities;
- Help identify products of interest to the US as well as possible impediments;
- Become an instrument for technology transfer;
- Develop linkages with small and medium-sized enterprises;
- Enhance trade and investment; and
- Create rational and clearer policies on the movement of people.

#### Issues and challenges at the domestic front

Despite the potential for economic gains, there are a lot of areas that should be considered in an FTA with the US. It is important to stress that with an FTA, there could be short-run adjustment costs, particularly in terms of possible displacement of some local industries that may not be able to compete and restructure. Furthermore, the government has to contend with strong anti-US sentiments in some sectors that see no merit in strengthening economic ties with the US.

Given these considerations, it is expedient that careful cost-benefit analysis be done before embarking on an FTA. The government should especially work on leveling the playing field to cushion the possible negative impact on the affected sectors. Outstanding issues affecting the country should be identified and resources and institutions organized to assess the effects of entering into an FTA with the US.

Initially, two things should be considered:

- 1) Sorting the technical areas – How much do we stand to gain? How much do we stand to lose? What are our negotiating points (e.g., guidelines for negotiating subjects such as subsidies, taxation, intellectual property rights (IPRs), investment, services, nontariff barriers (NTBs)

<sup>2</sup> From Liborio S. Cabanilla's paper on "Agricultural trade between the Philippines and the US: status, issues and prospects." Summary on pages 8-9.

<sup>3</sup> From Emilio Antonio and Maria Cherry Lyn Rodolfo's paper on "Assessing logistics: readiness of the Philippine garments industry," Summary on pages 10-11.

and safeguards), what areas should be guarded, what issues should be included and excluded, and how do we choose the technical team to oversee the preparations?

- 2) Gathering a mass base – This is especially important since FTAs have a wide-ranging effect on society. It is necessary that stakeholders from the public, private, and civil society sectors be involved in both the preparation and negotiation phases.

While there is a strong case for an FTA between the two countries given the potential benefits that can be derived, it is necessary that careful preparation be undertaken. The Philippines should thoroughly study the issues before engaging in formal talks as there are sensitive issues involved that can strain the relationship of the two countries. The succeeding sections discuss some of the major issues.

#### *On market access*

There are US nontariff barriers that pose structural, legal, and political impediments in enhancing market access, especially in sensitive agricultural and textile and garment products. While reforming the US agricultural policy cannot be hoped for in forging this FTA, one suggestion that has merit is to use the FTA as an opportunity to ask for as much special and differential treatment as possible, not only in terms of longer implementation period but also more exceptions on sensitive products. Being able to negotiate in these areas would be an important and concrete gain that would be visible and that would make the agreement more politically acceptable.

#### *On services*

The services sector is where the Philippines could potentially gain much, as shown by the dynamism in a number of information and communication technology (ICT) sectors and ICT-enabled ones. However, there is a need to understand more fully the impediments and constraints affecting the services

sector and bring these out in the negotiating table. The movement of natural persons (mode 4 of supply) is definitely a huge concern.<sup>4</sup> Then, there are key services areas where the Philippines is perceived to be weaker, for example, the financial sector. Possibly, the Philippines could push to offer only minimum commitments and negotiate for removing impediments to sectors with potentials such as business process outsourcing (where we appear to have a comparative advantage) and hopefully establish opportunities for Filipinos to work in the US. In relation to this, there is a need to align the services commitments to a broader national services plan or strategic framework that should be endorsed by the concerned sector. (A services coalition project is currently being undertaken by the Department of Foreign Affairs under the leadership of Undersecretary Edsel Custodio. The results of this project could prove useful.) The Philippines could also feasibly adopt a more cautious approach, especially from a political point of view, and push for a positive list approach.

#### *On investment*

The issue of national treatment is a sensitive area for the Philippines. Negotiators would prefer that particular attention is given to the exclusion of pre-establishment rights of investors (by excluding "those who seek to invest" as part of the definition of an investor), exclusion of portfolio investment and credit, and exclusion of "indirect expropriation" (or losses resulting from government regulation or policy) since investors claiming to have suffered from losses due to expropriation within this broad definition can take up cases against the host government for compensation. In the end, what is important is that the chapter on investments is supportive of the investment and development policies of the country, which call for more transparent, consistent, and stable investment rules and measures.

<sup>4</sup> From Tereso Tullao Jr.'s paper on "Issues and prospects on the movement of natural persons in the Philippine-American economic relations." Summary on pages 12,13, and 16.

### *On intellectual property rights*

This is a key issue for the US. On the other hand, the Philippine negotiators are mindful that the IPR provision on the FTA does not include TRIPS-plus provisions since there are already strict IP rules that developing countries have to comply with in the WTO as well as in the World Intellectual Property Organization. Specifically, there should be no restrictions on the ground of compulsory licenses, extended protection for patents and copyright, or restrictions on the rights that developing countries already have in the WTO.

These issues and concerns all the more highlight the need for a national development framework and overall development strategy that will advance the concerns of key sectors. Making sure that FTA policies are harmonized and the key provisions complementary is important to avoid the "spaghetti bowl effect" and to ensure that the policy contributes to the development goals of the country.

Related to this, it would also be worthy to examine the applicability of the Japan-Philippines Economic Partnership Agreement (JPEPA) framework to the proposed RP-US FTA. Bringing in some of the issues, concerns, and lessons from the JPEPA experience would be helpful in drawing the overall FTA framework.

### **Concluding remarks**

The RP-US FTA is a potentially controversial development policy option for the Philippines. Beyond the advancement of the economic agenda, it is an exercise in political economy, with serious non-economic ramifications. Careful preparation is therefore necessary before embarking on this challenge.

As such, there is a need to continue conducting in-depth studies on identified sectors and areas for negotiations. Stakeholders and affected sectors should actively take part in the preparations. It

would also be best if the participation of the private sector and civil society is drawn in. In this regard, it might prove useful to form a coalition that will oversee the preparations and negotiations for the proposed trade agreement with the US.

It is also necessary to keep watch of other FTA developments. Based on the US-Thailand FTA negotiation experience, the US appears to be adopting a hard line on using the US-Singapore FTA template. It is expected that similar demands will be brought in should the Philippines decide to pursue an FTA with the US. As such, there is a need to further study the applicability of the US-Singapore FTA, specifically on how acceptable and relevant the provisions are for the Philippines.

The US is known to be an adept negotiator in advancing its interest. For this FTA, a tough and carefully selected panel of negotiators is needed who will advance our agenda in the negotiating table.

There is potentially a lot to gain in establishing an economic partnership with the US. Macroeconomic studies conducted on the impact of a US-Philippines FTA support this. At the sectoral level, several studies also reveal that an FTA could be used as a platform to advance policies that would enhance the competitiveness of our local industries. However, it should be reiterated that there are challenges that should be dealt with, particularly with respect to the possible short-run dislocations that could result in strong anti-US sentiments from certain groups and in a negative perception regarding our negotiating capacity. Necessary preparations should be done by the government. Gaining the support of the people, as much as possible, in the major phases of preparation and negotiation is crucial.

Finally, it should be emphasized that an FTA with the US or any other country is

not an end in itself but only a means toward achieving our development goals and toward integrating the economy in the global trading environment. **DRN**

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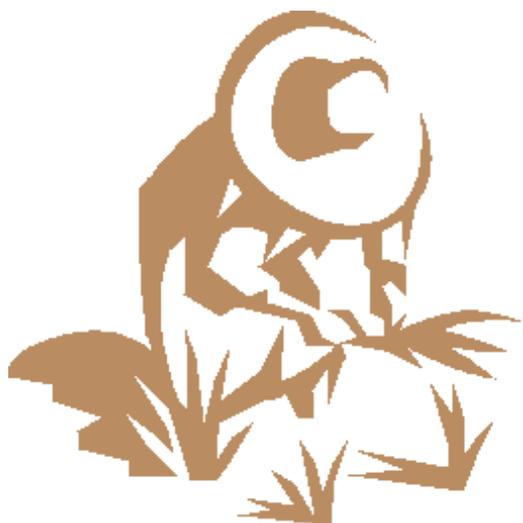
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## Free trade agreement with the US: What's in it for Philippine agriculture?

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Through a free trade agreement (FTA), the Philippines, like other less developed countries, hopes to achieve greater access to the US market. For Philippine agriculture, this is particularly significant given the unfavorable trend in its trade balance with the US—a stark contrast with neighbors Thailand and Indonesia that have enjoyed a favorable trade balance during the last decade. An FTA also has implications on the structure of Philippine agriculture as domestic production adjustments have to be made under a new trading arrangement.

The US is now the most important destination of Philippine sugar, coconut (oil and desiccated) and marine product exports. Of the Philippines' total coconut exports, close to 40 percent goes to the US every year. It has a yearly allocation of 13.5 percent in the US sugar quota, and thus enjoys a premium price, which was in the last 20 years roughly twice the world market price of sugar. For marine products, on average, the Philippines exports \$78 million worth to the US. In contrast, other high-value export crops like mangoes that are now major export items to Japan have not gained significant inroads in the US market. Phytosanitary issues constrain the growth of fresh mango exports to the US. Similarly, carageenan, a rapidly emerging export item of the Philippines, has not gained easier access to the US market due to

alleged political issues. Health issues also continue to be raised against coconut oil, while canned tuna exports are currently subject to a discriminatory 35 percent tariff rate in contrast to tariff-free canned tuna from Andean countries.<sup>1</sup>

The abovementioned issues are the main constraints to higher Philippine exports to the US. These constraints may, however, be relaxed with an FTA with the US. This should lead to a greater access of Philippine exports to the US market, at the very least maintain its share, particularly for commodities that are subject to government quota allocation. It is worth noting, for example, that among the 40 countries that now enjoy access to the US sugar quota, 27 are in various stages of negotiations for an FTA with the US. This is an important factor for the Philippines to consider given the US propensity to use discretionary measures that discriminate against exports especially from countries perceived to be not friendly.

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<sup>1</sup> Except for the 35 percent tariff on Philippine canned tuna, US tariff rates on most agricultural exports are low, and eligible for special treatment (under the Generalized System of Preferences).

It is also important to consider that the US is among the few rich countries that maintain high support measures (in addition to other programs such as Export Enhancement Program) for its agriculture. For example, the 2002 US Farm Act appropriates \$180 billion over a period of 10 years to support key agricultural production activities. Three commodity programs—Direct Payments, Counter Cyclical Payments, and Loan Deficiency Payments—are available for corn, soybeans, wheat, cotton, rice, grain sorghum, barley, oats, peanuts, other oilseeds, small chickpeas, and lentils.

These programs have important implications for Philippine agriculture, which is basically centered on rice and corn. Available information shows that through these commodity programs, US corn farmers receive total payments amounting to PhP1.07 per kilogram. This represents an income subsidy for US corn farmers that Filipino corn farmers do not enjoy. For equity reasons, this observation, and similarly for rice, may justify border protection for Philippine domestic rice and corn producers from US producers. Otherwise, an assistance program (similar to the PL 480) preferably for technology improvements in rice and corn may be crafted.

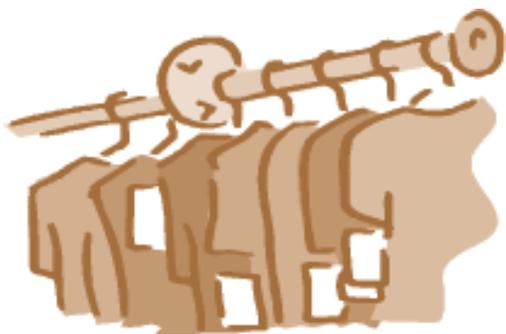
Among the major agricultural imports from the US, corn, rice, and, to a certain extent, poultry, will be the contentious issues for the Philippines. Rice and corn have always been considered “political crops” by virtue of their significance in the Filipino diet and the number of farmers dependent on them for livelihood. Increased imports of these crops are perceived to have a negative impact on a significant number of Filipino farmers. Thus, the assistance referred to above may also be used to help farmers shift to other production activities that are comparatively advantageous in their localities. For this, emphasis must be given to high-value commodities with high elasticities of demand in the world market.

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Poultry imports from the US are also perceived to be deleterious to domestic producers since the current tariff protection is not sufficient to countervail the artificially low-priced US exports comprised mainly of cuts least preferred by US consumers. This must be carefully looked into in the FTA negotiations. It is expected, however, that as the domestic price of corn declines as a result of an FTA with the US, poultry and other livestock production dependent on corn would benefit from the cost reduction, and thus facilitate the adjustment in the domestic output mix that may be more favorable in terms of an overall growth of the agricultural sector.

This short note has outlined the implications of an FTA on the agricultural sector. While no quantitative assessments have been made, we have presented the broad view that it is pragmatic to negotiate an agreement for agriculture because for one, it offers new opportunities for agricultural trade. At the very least, it preserves our trade position given the number of countries (our own competitors) that are currently negotiating for an FTA with the US. Because of its effects on the output mix, it opens the door for a structural transformation of Philippine agriculture that is favorable for higher growth and efficiency. **DRN**





# How do we now dress up the world?

Maria Cherry Lyn S. Rodolfo\*

In 1995, the Uruguay Round under the World Trade Organization (WTO) came into effect. Corollarily, the Agreement on Textiles and Clothing was signed which called for the removal of all quotas over a 10-year phase-out period. In effect, this Agreement integrated textiles and apparel into the mainstream of trade. How should the Philippines therefore position itself in this new era of trade in garments?

For stakeholders, the competitive regime has started as early as the 1990s. Our market share in the US declined from 5 percent (1995) to 2.8 percent (2004) due to the entry of more low-cost suppliers from South Asia, Eastern Europe, and the regions enjoying preferential access to the US. The Caribbean economies, for instance, gained significant increases in market shares via the Caribbean Basin Initiative (CBI). The North American Free Trade Area allowed Mexico to increase its share from less than 1 percent in 1991 to 7 percent in 1995 to 13 percent in 2004.

While the quotas gave business to many exporters, they also worked against competitive producers. Thus, the quota phase out is now an opportunity for the Philippines to sell its competitive products such as infant or baby garments and clothing accessories of synthetic fibers, men's/boys shirts (cotton), and women's/girls blouses and shirts (cotton). (A complete list of products that enjoy revealed comparative

advantage in the US is provided in the full report.)

For the Philippines to compete, the industry needs to move up in the value chain, significantly improve its supply chain and seek preferential access to the US. Buyers now choose suppliers who are not just cost-competitive but also reliable in quality and delivery of goods. They are willing to pay for transport costs to ensure lean retailing practices.<sup>1</sup>

In the past decades, the Philippines concentrated in the assembly portion of the buyer-driven value chain of the global garments industry. Only a few firms have become full package suppliers (e.g., original equipment manufacturing or OEM) by contributing to designs and offering after-sales services to their buyers. The industrial upgrading experiences of the Northeast Asian economies proved that moving away from mere assembly to become OEMs and OBMs (original brand manufacturing) is the way to overcome cost disadvantages (Gereffi and Memedovic 2003).

The phase out has raised concerns on a number of issues plaguing the industry for

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<sup>1</sup> Lean retailing means cutting down inventory to the minimum by requiring fast and on-time delivery from the manufacturer.

quite a long time now. Among these are: costs of labor, supply of raw materials, investments, logistics and infrastructure, access to financing, and trade facilitation.

The supply chain constraints are gradually being addressed through cooperation arrangements between industry stakeholders and the government through the Garments Industry Transformation Plan. Removing these constraints can increase the country's comparative advantage in the longer term.

The outcome of the phasing out of quotas will depend much more on the prevailing tariff rates and the preference margins of countries receiving such preferences (Nordas 2004). Given that the average tariff for apparel is 13 percent in the US, preferential treatment can make a large difference in the ability of a country to export to the US (Gibbon 2003 as cited in Appelbaum 2004). The Philippines' free-on-board (FOB) prices in the US are 17-32 percent higher than Thailand's, based on US data of apparel imports. If the duties are removed under a free trade agreement (FTA), the Philippines' point-of-sale price will likely go down by at least US\$6.

An FTA with the US will require the Philippines to hurdle the rules of origin (ROOs), primarily yarn-forward (yarn used in apparel must originate within the preferential partners) and fabric-forward (fiber must originate within the preferential partners). Except for the US-Jordan and US-Israel FTAs, the rest of the US FTAs require complex rules that represent a combination of local value content (LVC), change in tariff classification (CTC), and specific manufacturing processes.

A simple mode as in the case of a single transformation rule (i.e., cutting, sewing, and assembly) is recommended. The CTC is the least burdensome in terms of administration and the easiest to implement among the three. A combination of the three modes can only

lead to higher transaction costs for exporters. The LVC content rule in the US-Jordan agreement allows for regional cumulation, something which the entire ASEAN should pursue if the LVC becomes the rule. Furthermore, liberal tariff preference levels (TPLs) and short supply fabric list can increase the flexibility of exporters for some years while upgrading their local sourcing capabilities. Apart from tariffs, the implementation of the Customs Trade Partnership Against Terrorism (C-TPAT), which calls for the Philippines' customs and port facilities to conform with world-class port security initiatives that facilitate efficient security check and faster release of goods bound for the US, also serves as a non-tariff barrier.

Consolidation of resources among firms and investments generation for productivity enhancement are greatly needed. An FTA can likely increase the Philippines' competitiveness in the US market but the long-term solutions should be focused on industrial upgrading. Logistics must be improved and investments on physical and human capital must be made to improve the clustering programs between garments producers and textile firms so that the country can dress up the world. **DRN**

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An FTA can likely increase the Philippines' competitiveness in the US market but the long-term solutions should be focused on industrial upgrading. Logistics must be improved and investments on physical and human capital must be made to improve the clustering programs between garments producers and textile firms so that the country can dress up the world.



# Issues and prospects on labor migration and human capital development

Tereso S. Tullao, Jr. and Michael Angelo A. Cortez\*

Filipino labor migration to the United States can be characterized as mostly permanent with skilled workers and professionals taking on jobs that have been facilitated by various modalities and have surpassed immigration barriers. In this light, the educational services sector becomes a natural area of concern for the Philippines for it may present complementary values to the two trading countries.

With a slowdown in multilateral trade negotiations, the Philippines and the US can explore a bilateral trading arrangement that can advance trade in services. On one hand, the US as a major producer of educational services can take advantage of the English milieu in the Philippines in securing a sizeable market. On the other hand, the advanced state of education in the US may provide answers to some of the pressing needs of the Philippines' educational system.

In examining the bilateral flows in educational services using the General Agreement on Trade in Services (GATS) framework, the US can be seen as having an active role. For cross-border transaction (mode 1), the Philippines has old-style correspondence schools and distance education. Under consumption abroad (mode 2), a large number of Filipino students and scholars go to American universities under various scholarship and fellowship programs. Although minimal, there are American

exchange students who pursue studies in the Philippines. For commercial presence (mode 3), there are international schools and sectarian schools, at least initially controlled by foreigners including Americans. For the movement of natural persons (MNP; mode 4), a number of Filipino scholars who studied in the US have not returned and have contributed to the problem of brain-drain. While MNP per GATS definition is limited to professionals, skilled workers, and intra-corporate transferees, it can be used interchangeably with Filipino migrants as most of them fit the criteria.

In weighing the Philippine position in the bilateral trade agreement negotiations, the existing free trade agreements of the US should be examined with the North American Free Trade Agreement (NAFTA) as benchmark. The salient provisions that should be considered are the following: standard treatment; provisions that oblige members to agree on consolidated or liberalizing measures that may improve the conditions of service providers; no local presence requirement for foreign service providers; no citizenship or permanent residency requirement; unconditional most favored nation and national treatment; and liberal origin requirement.

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The US-Singapore agreement, which is now considered the most liberal, involved the movement of natural persons based on a list of qualifications. It provides that "a party shall not, as a condition for temporary entry, require prior approval procedures, petition labor certification tests, or other procedures of similar effect; or impose or maintain any numerical restriction relation to temporary entry".

The most serious barrier to the movement of Filipinos to the US now as a result of the FTA with Singapore is the US Congressional move to adhere to the primacy of the US immigration policy declaring that it would not pass a bill with immigration provisions similar to those contained in the Singapore and Chile agreements. This adds up to the already restrictive measures of the US concerning migration of Filipino workers. Thus, US employers are now faced with delays and additional costs in hiring Filipinos with extraordinary ability. They also have to prove that there is indeed an absence of a qualified US worker. On the other hand, the Philippines has a constitutional limitation on the practice of licensed professions and American nationals would have to be subjected to labor market tests.

Despite the hefty remittances coming from the US, the Philippines is confronted with a brain drain on professionals as a result of labor migration. Educated Filipinos who migrate to the US are unlikely to return. In fact, most of them change their residency status from working visas to permanent residency to eventual change in citizenship. To negate such an impact, the liberalization of the entry of professors, researchers, and scientists into the Philippines will have positive contributions on the development of research and instruction in higher educational institutions in the country.

While there is ambiguity on the definition of MNP, the Philippines can use the non-immigrant visa classification of the US immigration as an alternative to the

limiting definition of the GATS. MNP is often taken in conjunction with commercial presence and not as a separate mode in itself.

For the issue of access, while the Philippines could push for similar provisions in the NAFTA and the US-Singapore agreement as precedents, the country should be prepared to make sacrifices to accommodate requests from the US. The costs, sacrifices, and the relative importance to the overall country benefit should be weighed.

Another contentious issue is the payment of taxes and contributions to the US social security system by the worker, which he will not, however, enjoy if he is to be strictly considered as a temporary worker within the context of the MNP. It will only be beneficial if the migrant worker decides to be a permanent resident or a citizen of the US. It should thus be proposed that social security contributions of temporary workers be refunded in order to induce return migration.

On the issue of negotiating principle and liberalization, the Philippines should decide whether to go for the principle of reciprocity or preferential treatment. Given the unequal status between the two countries, the Philippines may compromise national interest and the Constitutional restriction on the employment of foreigners under a reciprocal mode of negotiations. A preferential treatment with a loose interpretation of reciprocity may still compromise other sectors in acceding to the demands of US negotiators. The importance of each sector and the mode that may be subjected to concessions and commitments must be weighed carefully.

In focusing on the education sector, the criteria for market access to foreign service providers should be defined. Given the advance level of development of higher education in the US, American service providers can contribute significantly in the human resource

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# The Agreement's politico-strategic dimension

Renato Cruz de Castro\*

The Bush Administration's recent efforts to negotiate and conclude free trade agreements (FTAs) with a number of countries, including the Philippines, are largely driven by politico-strategic motives. These motives include the US interest in advancing trade opportunities for American businesses and in ensuring its role as a leader in the global political economy. In pursuing these objectives, Washington must strike a delicate balance among competing domestic interests while meeting the challenges of realities brought about by the war on terrorism and the emergence of regional economic blocs. It has been a policy of the US since the end of the Second World War to promote the reduction of trade barriers and to develop a rule-based system based on multilateral institutions. The US believes that a more open trading system would provide more markets and businesses for American firms. Over the past 70 years, Washington took the lead in promoting a liberal trading system through multilateralism. The US took the lead in the formation of the General Agreement on Tariffs and Trade (GATT), which eventually became the World Trade Organization (WTO).

Since 1945, US trade policy has been consistently influenced by its three principal elements: adherence to an economic theory, federal legislation, and political expediency. In the hierarchy of the three, political expediencies mainly drive President George Bush's efforts at trade liberalization. The current Administration considers the FTA as the most credible and significant foreign policy instrument enabling the US to use its large and attractive market to influence

other countries' foreign economic policies. President Bush's trade liberalization policy consists of two major components. The first component involves the adoption of protectionist "safeguards," which the US government has often used in the past: antidumping measures and countervailing duties. These measures are taken primarily to protect certain domestic interests in the American economy—the steel and textile industries, and the agricultural sector. The other component involves competitive liberalization by forming bilateral and regional FTAs with a selected number of trading partners. This is primarily aimed at generating substantial pressure on other countries or regional economic blocs to open up their markets. From the Bush Administration's perspective, bilateral and regional FTA will trigger the forward momentum for trade liberalization as it will induce the world's major trading actors like the European Union (EU) and Japan to complete the broader, multilateral agenda of the WTO.

Recent international trends such as the war on terrorism and the growing economic prowess of the EU and China are poised to undermine American management and leadership role in the global political economy. The Bush Administration sought to offset these trends by forging bilateral FTAs with a number of countries in a "new coalition of the willing" in trade liberalization. Current US trade policy is a result of the interplay of various political

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factors such as balancing the interests between Congress and the President, complementing the American strategy on the war on terror, exerting pressure for another round of multilateral negotiations, and ensuring US access to the East Asian regional economy. The US must be able to reconcile these dynamics or it would risk isolating itself while other regional players such as the EU, China, and Japan assume a more pronounced role.

The proposal for an FTA between the US and the Philippines was first announced in March 2002. A few months later, in October, the US initiated the creation of the Enterprise for ASEAN Initiative (EAI). The EAI offers the prospects for an FTA to member-states of the Association of Southeast Asian Nations (ASEAN). The US was able to forge an FTA with Singapore and is currently negotiating for an FTA with Thailand. An FTA between the Philippines and the US would further strengthen their bilateral relationship, especially in the security realm. It can also lead to an increase of Philippine exports in the huge US market and contribute to the country's economic development. However, it is expected that the process leading to an FTA would entail numerous challenges for the Philippine government. Based on the Mexican experience during the negotiations and ratification of the North American Free Trade Agreement (NAFTA) in the early 1990s, it is presumed that the Philippines would experience intense political pressure from different interest groups who stand either to gain or to lose from the agreement. An FTA with the US would widen and generate more political cleavages in a society plagued with insurgencies. This will also affect some sectors of the economy (agriculture and services) as it may lead to massive business closures and job displacements. Radical political change might also occur due to the reforms needed to meet the macroeconomic requirements of the agreement. Finally, an FTA with the US also risks limiting Philippine foreign policy and puts the country in a bind with America in the future.

Despite these political ramifications, the Philippines cannot simply stay out of the US system of bilateral FTAs. This will mean trade discrimination against Philippine exports in the American market. It is expected that such an agreement with a superpower would generate domestic opposition. The government must be prepared to face such domestic backlash with a promised abundance of economic benefits to the majority of the people. The administration, therefore, needs to create a strong political sponsor in the form of a broad-based political coalition. This is the starting point of any effort to undertake radical economic reforms. In this regard, the coalition would be responsible in informing the public and enlisting support from the different sectors of the society.

The establishment of this coalition does not guarantee, however, the ratification of an FTA because the government will still have to take into account the legislature. The Mexican legislature was a spectator throughout most of the negotiating process, and a submissive supporter of the free trade during the ratification. The Philippine case might be different given the autonomy and activism of the Philippine Congress. Any local FTA coalition must realize early on that its interests will clearly offend the ideological sensibilities of the Left. The Philippine Left will consider an FTA with the US as a Faustian pact fraught with extreme dangers to the country, in which the promise of development and prosperity means greater US domination of Philippine society and the infringement of the country's sovereignty. In the final analysis, the signing and ratification of an RP-US FTA will be the easier part of the deal. The really crucial phase is making the promised cornucopia of economic benefits of an FTA a reality to the majority of the people. Failure to deliver these economic dividends will not only incite massive protest from the masses and consequent repression by the government. It will also trigger a massive political economic upheaval that will generate a more radical change in Philippine society. **DRN**

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able to compete and restructure. And what will happen to small farmers if the country becomes flooded with cheap rice and corn from the US?

This Philippine APEC Study Center Network (PASCN) issue of the DRN dwells on these issues and more. Now on its ninth year, the PASCN continues to provide excellent studies on various issues that challenge the region. This issue, for instance, features its research on the RP-US FTA, an overview of which is discussed in the banner article. Then, from the 14 studies written under the project, four were selected--their summaries published herein to give readers a brief yet concise look on the potential impacts of the proposed deal. These studies are on agriculture, garments, labor migration, and the political dimension of the FTA. **DRN**

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development of the Philippines. Under mode 1, research and graduate programs in almost all fields can be opened. Under mode 3, US service providers can be allowed to establish joint venture arrangements with Philippine schools offering priority undergraduate and key graduate programs. Under mode 4, the Philippines can liberalize the entry of scientists, researchers, and qualified professors in priority areas. The issue of national treatment in the granting of public subsidy, however, is problematic given that the government directly operates and funds some 113 state colleges and universities. Foreign service providers may be entitled to the same subsidy granted by the government to priority programs of colleges and universities and thus, compete for public funds. Public subsidy, therefore, will have to be directed toward priority programs of the government that are consistent with the

provision of public goods. Focus should be given to the ultimate objective. If the objective is access for students, then scholarship grants should be given directly to students. If the objective is to promote a priority program, the subsidy must then be given to a priority program. In both cases, the provision of public subsidy should not be based on the nationality of the institution but on priority programs that the government wants to promote.

There is also a need to have a mutual recognition on the qualifications and other requirements for Filipinos educated in the Philippines and are seeking employment in the US. This can enhance the competitiveness of Filipino workers in the global market.

Lastly, for the negotiating principle, the Philippines should adopt the positive-list approach because this will enable the Philippines to identify and offer sectors and professions that are ready for liberalization instead of opening the entire services sector and listing the exemptions. **DRN**