Issues on international trade and investment and its implications for further research

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ABSTRACT

Recent developments in the field of international trade and investments worldwide have led to contemporary literature that encompass international trade in goods and services, trade policies, bilateral and regional free trade agreements (FTAs) as well as multilateral trading arrangements, trade facilitation measures, and foreign direct investment (FDI) policies. Given the increasing significance of multilateral trade and FDI flows between regions in recent years, there is a need of further research especially for developing countries like the Philippines. As such, it will be possible to develop efficient trade and investment policies, which relate to inclusive growth and development. Results suggest that the Philippines needs to maximize the economic gains and mitigate the economic costs associated with freer international trade in goods and services; more memberships in bilateral and regional FTAs; greater flows and volatility in FDIs; and a more liberal trading and investment environment.

Keywords: international trade, foreign direct investment, research, free trade agreements, non-tariff measures

I. Introduction

The past decades saw the influx of new research issues encompassing international trade and investments. Among the related topics are in the areas of international trade in goods and services, trade policies, bilateral and regional free trade agreements (FTAs) as well as multilateral trading arrangements, trade facilitation measures, and foreign direct investment (FDI) policies. These research areas may have emanated from the recent developments in the field of international trade and investments worldwide. Conducting research on each of these is vital, especially for developing countries like the Philippines; this is because new knowledge to be generated out of such research could result in appropriate trade and investment policies for the country, allowing it to fully reap the benefits of globalization and be able to attain inclusive growth and development.

In recent years, the world economy has witnessed the proliferation of bilateral and regional free trade agreements (FTAs); the increasing number of multilateral trade commitments; the increasing relevance of trade facilitation measures amid the persistence, and in certain cases, the rise of non-tariff measures (NTMs); the increasing bilateral FDI flows between developed
and developing regions as well as between economies within developing regions; the growing importance of trade in services (as evidenced by strong remittance growth of overseas workers); and improvements in better understanding the potential role of international trade and investment in economic growth and development, including poverty reduction.

For the Philippines, this study highlights that among the important research issues in relation to international trade and investment lie in the following: (1) A better understanding of the economic and developmental implications of actual and planned FTAs, as well as multilateral trade issues, in the Philippines; (2) Identifying major non-tariff measures (NTMs) facing the country’s exporters and importers; (3) Determining the key factors of and barriers to the country’s services trade; (4) Knowing the importance of improving trade facilitation and addressing “behind-the-border” issues that hamper Philippine trade in goods and services; and (5) Establishing to what extent macroeconomic factors, public institutions, business environment, and infrastructure development can influence FDIs into the Philippines and knowing the spillover effects of these FDIs on Philippine-based firms.

II. Bilateral or Regional Free Trade Agreements and Multilateral Trade Arrangements

2.1. Bilateral or Regional Free Trade Agreements

FTAs at both the regional and bilateral levels have expanded worldwide including in developing Asian economies over the past two decades. According to the Asian Development Bank’s (ADB) Asia Recovery Information Center (ARIC), as of 2010, there were 238 planned and actual FTAs in developing Asian economies, a significant increase from 54 FTAs in 2000. Out of these FTAs, 76% are bilateral and the rest are plurilateral. Moreover, there were 1 bilateral FTA within Southeast Asia, 12 within East Asia, 11 within South Asia, and 7 within the Pacific. It has been argued that the Association of Southeast Asian Nations (ASEAN) is seen to be the leader when it comes to regional economic integration, given that it is the first to have committed (in 1992) to form an FTA; to establish a charter with legal rules (in 2008) for its member countries; and to develop a blueprint for establishing an ASEAN Economic Community (AEC) by 2015 (ADB, 2010).

There has been extensive debate and literature on the pros and cons of FTAs to member and non-member countries. Overall, FTAs can lead to static economic benefits, such as trade creation whereby its member countries would be able to enhance their respective merchandise trade and trade in services amongst themselves and with the rest of the world. Possible dynamic positive impacts of FTAs include economies of scale—taking advantage of expanding market share and resource pooling in order to boost production at minimal average costs—and attracting long-term foreign investments.

The potential cost of FTAs is trade diversion in which non-member countries would be adversely affected by the diversion of its trade to non-efficient producers who are member countries, and may strain trade relations between member and non-member countries. Another potential negative impact of FTAs is the so-called “spaghetti bowl” or “noodle bowl” effect, which presents the intricate and sometimes inconsistent nature of rules of origin (ROOs), which are likely to hamper free flow of goods and services.
The ADB (2008) argues that the main drivers of FTAs in Asia are: (1) Defensive response to the proliferation of FTAs in other regions; (2) Promotion of structural reforms that are “beyond the border”; (3) Urgent need to enhance productivity in light of the intensifying competition coming from the People’s Republic of China (PRC) and India; and (4) Uncertainty over multilateral trade negotiations in the World Trade Organization (WTO).

Kawai & Wignaraja (2010) recommend that there ought to be a region-wide FTA for the Asia-Pacific region, i.e., to consolidate FTAs in the region with the likely scenario an initial FTA consisting of the People’s Republic of China (PRC)-Japan-Republic of Korea FTA, and then combining it with an Association of Southeast Asian Nations (ASEAN)+1 FTA, and then include Australia, India, and New Zealand.

The Philippines has been involved in a number of FTAs, including the ASEAN Free Trade Area (AFTA), ASEAN-China Free Trade Agreement (ACFTA), and the Japan-Philippines Economic Partnership Agreement (JPEPA). Certain quantitative and qualitative studies have looked at the role of these FTAs on the Philippines. For instance, Corong, Reyes, & Taningco (2010) show in their static computable general equilibrium (CGE) model for the Philippine economy that the combined Common Effective Preferential Treatment (CEPT) of AFTA and the WTO’s Most-Favored-Nation (MFN) tariff reductions (coupled with a direct income tax to offset tariff revenue losses) would marginally raise national output; improve the industrial sector while worsening the agricultural sector; increase gross household income but lower disposable income and consumer prices; and reduce national poverty and benefit the poorest of the poor. Still on AFTA, Medalla & Balboa (2009) argue that the rules of origin of AFTA under its CEPT scheme is “relatively simple and liberal”, but the cost of compliance with its rules of origin needs to be reduced and that there is still room for improving the CEPT’s utilization rates.

Medalla, Vidar-Valle & Balboa (2010) conjecture that JPEPA would allow the Philippines to acquire significant gains from having a more conducive investment climate brought about by more access to Japanese capital, expertise, and technology. In a simulation analysis of a partial equilibrium approach, Medalla & Balboa (2007) showed that the Early Harvest Program under the ACFTA would result in an overall loss for the Philippine agricultural sector, particularly in the vegetables and hogs sub-sectors.

One of the proposed regional FTAs that would involve the Philippines is the East Asian FTA. It has been conceived by Medalla & Mantaring (2009) that the East Asian FTA is a right partnership for the Philippines, given the region’s economic importance, large size, and geographical location, and that there are complementarities amongst East Asian economies that have yet to be availed of.

However, amidst the potentially massive economic benefits of FTA’s for the Philippines, there are still many local firms that lack familiarity with FTAs and are not utilizing them. This has been confirmed in an ADB book edited by Kawai & Wignaraja (2010), wherein it found that 70% of Philippine firms surveyed said that the biggest impediment for using FTAs is their lack of information on these FTAs.
2.2. Multilateral Trading Arrangements: The WTO and the Philippines

It has been argued that the WTO provides three key services in the multilateral trading system: (1) a venue for multilateral trade negotiations; (2) a tool for mediating trade disputes between its member countries; and (3) a source of information on member countries’ policy changes that affect commercial interests (Bown, 2010).

The Philippines formally entered the WTO as a member country during 1994. Since then, the country has made commitments that are consistent with the most-favored-nation (MFN) principles and national treatment. For example, the country started to bind tariff lines at certain levels and has enacted laws that are consistent with the spirit of the WTO rules. Among these reforms undertaken during the late 1990s were the “tariffication of quantitative restrictions on agricultural imports in 1996, the enactment of a law in 1998 calling for compliance to the WTO’s Trade-Related Aspects of Intellectual Property Rights agreement, and promulgation of the “Anti-Dumping Act of 1999”. Indeed, between 1992 and 1999, the country’s simple average applied MFN rate fell from 26% to 9.7% in 1999 (WTO, 1999).

However, the pace of progress in multilateral trade reforms in the Philippines began to slow down in early 2000s (WTO, 2005). The average applied MFN rate further fell to 5.8% in 2003 but climbed to 7.4% in 2004. It was learned that this MFN rate reversal was caused by tariff hikes enforced by the government to help ailing domestic industries. Nevertheless, new laws consistent with WTO rules were crafted during this period, such as the “Safeguard Measures Act” in 2000 and the 2003 law regulating government procurement.

There were a few instances wherein the Philippines became involved in a WTO dispute settlement with another country. In 2008, the Philippines filed a complaint against Thailand in the WTO alleging that Thailand violated the General Agreement on Tariffs and Trade (GATT) provisions with respect to its application of fiscal and customs measures on cigarettes coming from the Philippines. This case was handled by a panel, which was formed by the WTO’s Dispute Settlement Body in 2009. In 2010, the panel released its findings, which were upheld by the Appellate Body, showing that Thailand violated with the related provisions in GATT.

Another dispute settlement case involved the United States’ (US) distilled spirits exports to the Philippines. In 2010, the US government sought consultation from the WTO claiming that the Philippines violated GATT provisions in applying import duties on US distilled spirits. In 2011, the WTO panel ruled in favor of the US.

Since 2005, the WTO’s trade policy review on the Philippines has yet to come out. This makes it difficult to know the more recent reforms on multilateral trade in the Philippines, particularly during the second half of the 2000s and the early years of 2010s. Furthermore, to our knowledge, there has been no existing literature that provides empirical evidence on the economic impacts of such multilateral trading commitments and reforms made by the Philippine government on its domestic economy, particularly on its trade and investment.

2.3. Policy Research Implications
This study proposes that further research is needed to better understand the potential economic effects of certain bilateral and regional FTAs, as well as multilateral trade commitments, on the Philippines. Among the specific research topics this paper suggests are as follows:

- A simulation study (ex. CGE-microsimulation modeling) on the possible economic, sectoral, and/or poverty impacts of establishing an East Asian FTA (ex. ASEAN+3 and ASEAN+6) on the Philippines.
- A simulation study (ex. CGE-microsimulation approach) on the potential economic, sectoral, and/or poverty impacts of having an Asian Economic Community (AEC) on the Philippines.
- Case studies on the actual economic effects of FTAs on Philippine firms, including small- and medium- enterprises (SMEs).
- A study of WTO-consistent regulatory reforms conducted by the Philippine government and its impact on the Philippine economy.

2.4. Trade in Services

The literature on trade in services has expanded in the past years, amid the increasing level of cross-border services flows. Indeed, the WTO (2008) documents that the growth in international trade in services has been more rapid than merchandise trade in recent years. Moreover, since the early 1990s, around 95 regional trading arrangements covering trade in services have been notified to the WTO under GATS’ Article V by the end of June 2011 (Stephenson & Robert, 2011).

Certain studies on services trade have used a gravity model, similar to the one used in trade in goods, and have found that the general determinants of services trade are economic size, distance, and cultural/historical factors (see for example Kimura & Lee, 2006). Other studies have looked at the economic impact of services trade. Shepherd & Pasadilla (2011) provide empirical evidence to show that a less restrictive policy on services trade and appropriate services trade liberalization can help promote human development.

Various reforms on trade in services were made in the past years at the multilateral level. In January 1995, the WTO introduced the General Agreement on Trade in Services (GATS), which contained a set of multilateral rules governing international trade in services and encompassed four modes of services trade—cross-border supply (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3), and presence of natural persons (Mode 4).

In December 1995, the ASEAN Framework Agreement on Services was signed by 7 ASEAN member countries, namely, Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam, with the objectives of liberalizing and enhancing cooperation in services, as well as easing the restrictions on trade in services amongst member countries. This agreement was crafted by the ASEAN member countries to be consistent with GATS.

In July 2007, the ASEAN-China Agreement on Trade in Services (ACATS) took effect, enabling its member countries, including the Philippines, to commit to greater market access and improved national treatment for service providers in the region.
In the Philippines, there still exist barriers to services trade. For example, there are limitations to foreign participation in the banking sector. Also, foreign equity in finance companies and stock underwriting is restricted to 60%. Foreign ownership in a telecommunication firm, which is considered by the country’s laws as a public utility, is limited to 40%, while in advertising agencies, it is 30%. Only Philippine citizens are licensed to practice certain professional services (ex. Accounting, law, medicine, etc.)

Against this backdrop, this study proposes the following research topics:

- A comprehensive review of the existing barriers to services trade in the Philippines under each of the four modes in GATS.
- An empirical study to identify the determinants of Philippine services trade.

2.5. Tariff & Non-tariff Measures, Trade Facilitation in the Philippine Context

The past years saw a reduction in the traditional trade barriers—import tariffs and quotas—but a proliferation of NTMs and other non-tariff barriers in many countries around the world, including the Philippines. It is important to mention that the Philippine unilateral tariff liberalization reforms were helpful in providing various economic benefits to the country. For instance, Aldaba (2010) used panel data of Philippine firms over the 1996-2006 period, and finds that tariff liberalization tends to lead to productivity gains whereas tariff protection is associated with productivity losses.

However, technical and other trade barriers and NTMs still remained and have in fact proliferated. Pasadilla and Liao (2006) have shown that NTMs imposed by the Philippines’ top agricultural export markets in East Asia, specifically, People’s Republic of China (PRC), Japan, and South Korea, have made it difficult for Philippine agricultural exporters, especially the small- to medium-scale agricultural producers, to comply with the stringent NTM requirements in these countries, and thereby hampering the Philippine’s agricultural exports. It has also been indicated that non-tariff policy-related trade costs of the Philippines has increased slightly between 1996 and 2007 (Duval & Utoktham 2011).

Trade facilitation has been defined by the ADB (2009) as the “systematic rationalization of customs procedures and documents…” in its narrowest sense, and, in a broader sense, “covers all the measures that affect the movement of goods between buyers and sellers, along the entire international supply chain.”

There have been several studies on the topic of trade facilitation in East Asia (Hernandez & Taningco 2010, Shepherd & Wilson 2009, Duval & Utoktham 2009). For example, Hernandez & Taningco (2010) use a gravity model (with panel regression specification) for 10 East Asian economies—People’s Republic of China (PRC); Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam—over the 2005-2009 period, and find that bilateral merchandise trade flows within the East Asian region are associated with trade facilitation measures, specifically, time delays in trade, quality of port infrastructure, telecommunications service, and depth of credit information. They also find that there is substantial variation of trade facilitation measures across product groups, with time
delays being more influential in trade flows in food and beverages (due to its “perishability”) and in transport equipment (as in this sector, there is production sharing and enforcement of just-in-time business practices).

Meanwhile, Shepherd & Wilson (2009) utilized a standard gravity model framework and find that bilateral merchandise trade flows within member countries of the Association of Southeast Asian Nations (ASEAN); the PRC; Hong Kong, China; and Taipei, China are negatively associated with distance and tariffs, and are positively associated with historic-cultural ties, transport infrastructure, and competition in the Internet services sector. Also, Duval & Utoktham (2009) find that a 5% reduction in the delivery cost for a good from the factory to the nearest port could result in a four% rise in merchandise exports, and that improving credit information could increase merchandise exports by 16%. They also argue that simplification of domestic contract enforcement procedures to the average level of the member countries in the Organisation for Economic Cooperation and Development (OECD) can boost merchandise exports by 27%.

Duval & Utoktham (2011) found that improving port efficiency and easing access to information and communication technology (ICT) facilities is crucial in lowering trade costs in the Asia-Pacific region. They have suggested that engaging in public-private partnerships (PPPs) may be needed in order to fast track the development of ICT and transport infrastructures. They added that prioritizing the improvement of the business environment may be more effective than developing soft infrastructure in implementing trade facilitation measures.

Grosso & Shepherd (2011) used a gravity model on Asia-Pacific economies and find that a more liberal air transport policy is positively associated with bilateral merchandise trade, particularly in manufactured products, time-sensitive products, and parts and components.

However, there is a limited number of studies that looked at trade facilitation measures on the Philippines alone. For instance, De Dios (2010) looked at survey responses on the role of information technology (IT) in trade facilitation on small and medium-sized enterprises (SMEs) and find that that majority of the problems encountered by importers are IT-related, specifically: (1) Internet connectivity problems; (2) System breakdowns; (3) Inadequate electronic lodgement; and (4) Costly IT investments.

Overall, this study suggests the following topics merit further research:

- Identification of Key NTMs Facing Philippine Exporters and Importers;
- Role of Infrastructure in Philippine International Trade.
- Financial Sector Development and Merchandise Trade of the Philippines: The Case for Trade Finance.

III. Foreign Direct Investments: Implications for Philippine Research
There exist several new studies that looked at the determinants and effects of FDIs for Asian economies. Petri (forthcoming) uses bilateral FDI flow data of a set of 85 countries over 1999-2003 period and utilizing a gravity model approach, finds that inward FDIs into Asia are attracted by technology policies, and that bilateral FDI flows within Asia are significant between high-technology and low-technology economies. In the PRC, Xu & Sheng (forthcoming) use firm-level data for the country’s manufacturing sector over the 2000-2003 period, and find that FDIs have positive spillover effects on firm productivity in the same industry, and that these spillover effects are regional in nature, suggesting that domestic firms will benefit more from foreign firms’ presence in the same sector in the same region. Cuyvers, et al. (2011) found that FDI inflows into Cambodia are positively associated with its gross domestic product (GDP), bilateral trade with the source country, and exchange rate, and are negatively affected by its geographical distance with its investment partners. Takii (2011) found that multinational corporations from East Asian economies have positive spillover effects on the productivity of Indonesian manufacturing firms. In the case of Chinese manufacturing firms, however, Sun (2010) notes that the FDI spillover effects on exports varies (and are heterogeneous), with some firms receiving positive effects while other firms incurring negative effects.

In the Philippines, the National Statistical Coordination Board (NSCB) reported that approved FDI rose 32.2% year-on-year (y-o-y) to PHP116.6 billion in the fourth quarter of 2010; this is the third-highest level of approved FDI since the first quarter of 1996. Japan registered the largest committed FDI into the country at PHP41.2 billion (35.3% share), followed by Netherlands and the Cayman Islands at PHP29.8 billion (25.5%) and PHP10.6 billion (9.1%), respectively. The manufacturing sector received the largest pledge of FDIs at PHP103.8 billion or 89% of the total.

The resurgence of approved FDIs into the Philippines is likely to be attributed to improvements in investor confidence and the country’s business environment. The Bangko Sentral ng Pilipinas (BSP) reported that business optimism remains strong in the Philippines with the overall confidence index at 47.5% in the first quarter 2011 after reaching a record-high 50.6% in the fourth quarter of 2010. Moreover, the confidence index for the next quarter (i.e., second quarter 2011) jumped to an all-time high 59.4%, indicating better outlook and business sentiment in the upcoming quarter.

There, however, is paucity of empirical studies on FDIs in the Philippine context. Against this backdrop, this paper proposes the following areas for further research:

- **Macroeconomic Determinants of FDIs into the Philippines.** This research aims to empirically identify the macroeconomic factors (ex. GDP growth, inflation rate, real exchange rate, interest rate, government’s budget, etc.) affecting FDIs in the Philippines. This may be helpful for the incumbent administration in crafting appropriate fiscal and monetary policies that are aligned with attracting more FDIs into the country.
- **The Role of Institutions on Business Environment & FDIs in the Philippines.** There is anecdotal evidence that institutional bottlenecks and negative business sentiment in the Philippines tend to hamper FDI inflows. In particular, it has been gathered that endemic corruption and inefficiency in public sector institutions result in low investor
confidence, thereby negating FDI inflows. There is a need to verify this with an empirical study.

- **FDIs, PPPs, & Infrastructure Development in the Philippines.** One of the major thrusts of governments in developing Asia is infrastructure development in order to attain inclusive growth. However, as Asian governments experience fiscal consolidation due to their fiscal stimulus efforts in response to the 2008-2009 global economic and financial turmoil, there is now greater need for more active private sector participation. Hence, the public-private partnerships (PPPs) to boost infrastructure financing have been revived. As the Philippine government embarks on infrastructure development through PPPs, there are calls for feasibility studies to pinpoint PPP projects. In this regard, there may be a need to formulate a rigorous study to determine the extent of infrastructure development and PPPs on FDIs in the Philippines.

- **Firm-level Study on FDI Spillover Effects across (or within) Sector(s) and Regions in the Philippines.**

**IV. Conclusions**

The Philippines needs to maximize the economic gains and mitigate the economic costs associated with freer international trade in goods and services; more memberships in bilateral and regional FTAs; greater flows and volatility in FDIs; and a more liberal trading and investment environment. This necessitates greater awareness and more familiarity on the potential economic effects of these trends in international trade and investment amongst the stakeholders in the country—households, firms, and government.

This study provides the recent trends on the relatively important issues on trade and investment—such as FTAs and multilateral trading arrangements, trade in services, tariff measures and NTMs, trade facilitation, and FDIs—and their policy implications to the Philippines. It emphasizes the need for more research in these areas. On the area of FTAs, this paper proposes for research studies that will simulate the potential economic, sectoral, and/or poverty impacts of an East Asian FTA (ex. ASEAN+3 and ASEAN+6) on the Philippines using a general equilibrium framework. It also proposes to document the more recent reforms and commitments undertaken by the Philippine government that are consistent with MFN principles and national treatment, and to analyze their economic impact. Moreover, case studies highlighting the experiences of Philippine firms involved in certain FTAs are likewise suggested by this paper.

On trade in services, this paper suggests to conduct research that will identify the existing barriers to services trade in the Philippines with respect to the four modes as outlined in GATS. It also pushes for further empirical research in identifying the key drivers of services trade of the country.

On tariff measures, NTMs, and trade facilitation measures, this paper hints on the need for empirical evidence (based on a gravity model framework) on the role of trade costs and “behind-the-border” measures on bilateral merchandise trade (at the national and sectoral levels)
between the Philippines and the rest of the world. Moreover, this paper argues that further research on identifying the major NTMs facing Philippine exporters and importers is desired.

Developing physical and soft infrastructures has become one of the main agendas of governments, the private sector, and multilateral agencies in developing Asia, including the Philippines. Against this backdrop, this paper calls for empirically-based research on the role of infrastructure in Philippine trade. Likewise, the development of financial markets has been viewed to have a link with international trade; researching this further in the Philippine context has also been called for in this paper.

Finally, FDIs have become an important element in inclusive and economic growth and development. In the Philippines, however, there is a paucity of research tackling the role of FDIs in the country. This paper proposes that research must be pursued in terms of: (1) Identifying the macroeconomic determinants of FDIs into the Philippines; (2) Establishing the role of institutions on Philippine business environment; (3) Linking infrastructure development and FDIs in the Philippines and the significance of PPPs in attracting FDIs; and (4) Examining the spillover effects of FDIs on Philippine firms.

V. Endnotes:

1. www.aric.adb.org
2. The ASEAN defined the AEC as a “highly competitive economic region” with “equitable economic development”, a “single market and production base”, and is highly integrated with the rest of the world. It encompasses certain areas of cooperation that include capacity building and human resource development, trade financing, connectivity in infrastructure and in information and communications technology, closer macroeconomic and financial policy coordination, and greater private sector involvement, among others. (See http://www.aseansec.org/18757.htm)
3. ASEAN+3 comprises of Brunei Darussalam; Cambodia; People’s Republic of China; Hong Kong, China; Indonesia; Japan; Republic of Korea; Lao PDR; Malaysia; Myanmar; Philippines; Singapore; Thailand; and Viet Nam.
4. ASEAN+6 comprises of ASEAN+3 economies as well as Australia, India, and New Zealand.

VI. References

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