FTAs and Philippine Business

Evidence from Transport, Food and Electronics Firms

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Messages

- With stalled Doha talks, FTAs are here to stay in Asia
- Asian business is adjusting and increasingly using FTAs
- Philippines is a latecomer to FTA and relies largely on ASEAN
- A more pro-active FTA strategy will increase FTA use and business adjustment

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I. Setting and Research

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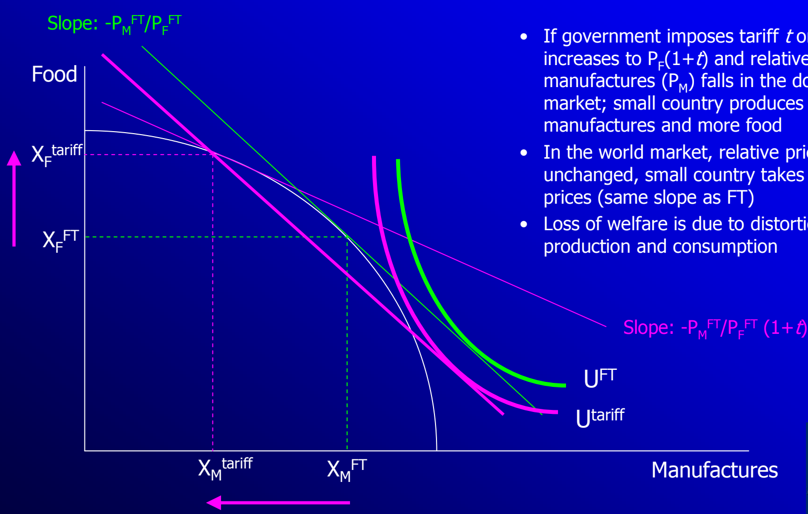
Trade Protection vs. Free Trade

The Case of a Small Open Economy



- If government imposes tariff t on food, P_F increases to $P_F(1+t)$ and relative price of manufactures (P_M) falls in the domestic market; small country produces less manufactures and more food
- In the world market, relative price is unchanged, small country takes the world prices (same slope as FT)
- Loss of welfare is due to distortion in production and consumption

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Forms of Trade Agreements

- Free trade area (FTA): removal of tariffs and other trade regulations that restrict trade among the members
- Customs union (CU): an FTA plus common external tariff to third parties
- Common and single market: FTA among members in goods, services, capital, and labor; entails removal of all barriers and trade regulations that restrict trade among members
- Economic and monetary union: common market and unification of economic institutions and coordination of economic policy among member countries; supranational institutions with decisions binding all members; a single currency and a single central bank

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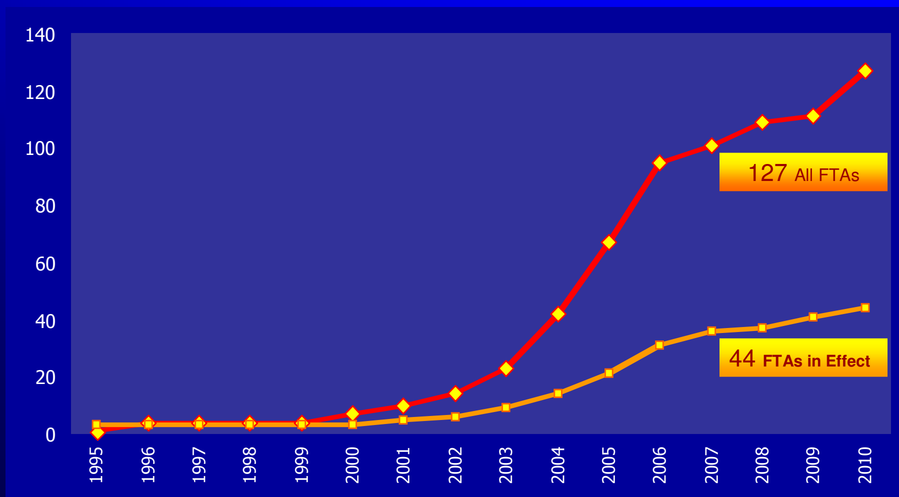
Growing Number of FTAs in East Asia



All FTAs includes concluded FTAs, FTAs under official negotiation, and proposed FTAs in East Asia.
East Asia covers the 10 ASEAN members; Japan; Korea, PRC; Hong Kong, China; and Taipei,China.
Source: ADB FTA Database www.aric.adb.org (data as of January 2010)

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Reasons for the Surge of FTAs

- Proliferation of regional trading blocks elsewhere (EU, NAFTA).
- Slow progress of global trade talks.
- Complementarity with WTO process— FTAs can induce market opening and structural reforms in protected sectors.
- International competitiveness through scale economies.
- Deeper regional integration and greater institution building.

The Asian Noodle Bowl

- Spread of FTAs triggered concerns about crisscrossing FTAs – (Bhagwati's "spaghetti bowl of trade deals", 1995, 2008).
  - Discriminatory trade liberalization with multiple FTAs means different tariffs and ROOs for same commodity.
  - With FTA growth, international trading system chaotic and raises transaction costs for SMEs.
- ADB President Kuroda (2006) referred to same phenomenon as the "Asian Noodle Bowl" effect of FTAs – one that could present challenges for broader regional and global integration.

Little empirical evidence on impact of Noodle Bowl on firms to shed light on debate…

ADB/ADBI Firm Surveys

- Aims:
  - ✓ Provide firm-level evidence on the business impact of FTAs
  - ✓ Assess the severity of the 'Noodle Bowl' on business and offer suggestions for tackling it
- 6 enterprise surveys in 2007/2008 - Japan, PRC, Korea, Singapore, Thailand, **Philippines**
  - ✓ Large, diverse dataset (841 manufacturing firms)
  - ✓ ADB and different partners involved in surveys

For more information…

- ✓ Country studies and overview available at: http://www.adbi.org/preview/research.free.trade.agreements.asia/
- ✓ *Business Impact of Free Trade Agreements in East Asia* (ADB/ADBI book with Edward Elgar Press, forthcoming 2010)

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Key Findings

- Utilization rate is higher than expected and may increase in future.
  - ✓28% of firms use (45% in PRC)
  - ✓53% of firms use/plan to use
- ROOs impose limited burden on firms at this time.
  - ✓Only 20% of firms said that multiple ROOs significantly add to business costs.
  - ✓Less 1% of export sales

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II. Philippines Trade Policy Background and Trends

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Multi-Track Liberalization

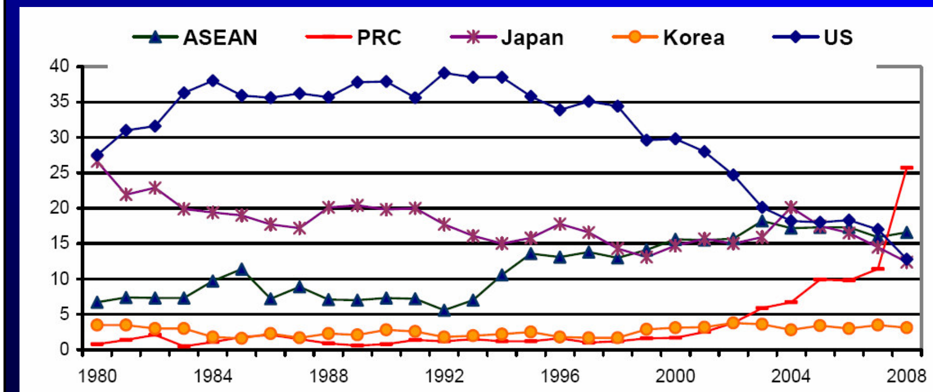
Regime	Trade Policies	Investment Policies
Unilateral Trade Liberalization	–Inward-looking import-substitution policy & Export Incentives Act (1960s to 1970s) –Tariff Reform & Import Liberalization Programs (1981-2003) & Export Development Act (1994) –Signed WTO Agreement (1994) –Implemented Information Technology Agreement (2000)	–Established export processing zones –Foreign Investment Liberalization Act (1991); Special Economic Zone Act (1995); Omnibus Investment Code –Industry clustering (*One Town-One Product program*) –Foreign Trader's visa (EO 758)
Liberalization through Regional Integration	–Joined AFTA (1992) and implemented CEPT (1993); Implemented ASEAN Industrial Cooperation Scheme (since 1999) –Party to ASEAN-China CECA (2004); ASEAN-Korea Agreement CECA (2006); ASEAN-Japan CEPA (2008); ASEAN-Australia-New Zealand FTA (2009); and ASEAN-India CECA (2009) –Negotiating ASEAN-plus FTAs (EU); considering an East Asian FTA (+3 or +6)	–ASEAN Investment Area –Investment chapters in FTAs –APEC non-binding investment principles
Bilateral Approach	–Signed Trade and Investment Framework Agreement with US (1989) –Signed Japan-Philippines EPA with investment provisions (in effect Dec. 2008)	

Tariff Structure & Preferences

- Average MFN rate 6.35% (2009) is low by developing country standards
  - ✓ Electronic inputs are mostly duty free
  - ✓ Dispersion has also fallen, with most items within the 0–10% tariff range
- …But residual protection still remains in agriculture, some manufacturing (textile, transport and foods)
- ASEAN FTAs offer preferential market access in goods, JPEPA with services & cooperation

Increasing Trade with FTA Partners

Share of exports from the Philippines to FTA Partners and the US, 1980–2008 (%)



Source: Authors' computation based on Direction of Trade Statistics (IMF 2009); data as of June 2009.

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III. Firm Survey Findings from the Philippines

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Research Questions

1. Do firms use AFTA and why?
2. What impedes firms from using FTAs?
3. How can we improve FTA use?

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Philippine Sample Profile

		Sector			Ownership		Location			
Size	All firms	Transport	Food	Electronics	Domestic	Foreign	PEZA	Non-PEZA	NCR	Non-NCR
Small	64	13	26	25	31	33	27	37	24	40
Large	81	22	16	43	24	57	50	31	21	60
Giant	10	1	1	8	0	10	5	5	3	7
All firms	155	36	43	76	55	100	82	73	48	107

Note: Foreign firms defined as firms with at least 10% foreign equity share.
Size is by number of employees: Small=100 or less, Large=101-1,000; and Giant=more than 1,000.
Location is by economic zone membership: PEZA; non-PEZA and geography: national capital region (NCR) refers to Metro Manila area; non-NCR.
Source: Authors' computation based on survey data.

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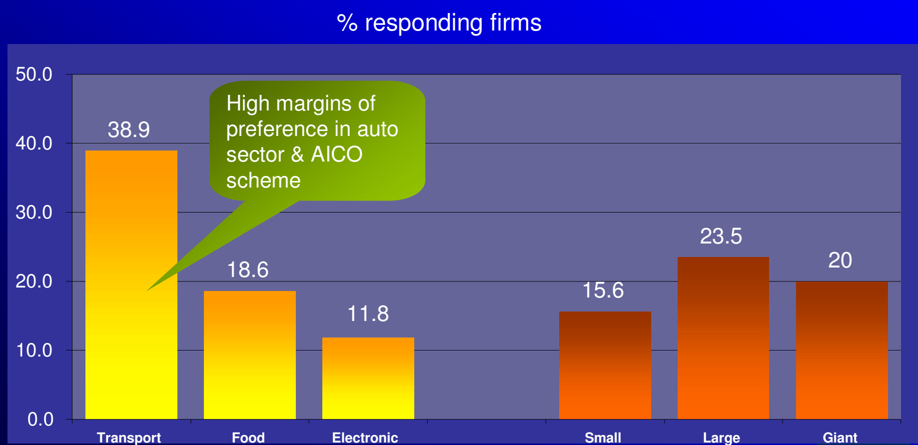
Q1. Do Firms Use AFTA?

Use is higher than expected (20%) and may increase in future (40.7%)



Note: As a % of the total number of responding firms per sector and size.
Source: Authors' computation based on survey data.

Significant Predictors of AFTA Use

- Firm age
- Domestic ownership and market orientation
- Participation in FTA consultations with government or the private sector
- Some knowledge of FTA provisions
- Industry affiliation - transport sector

Firms Perceive Net Benefits

No. of firms that reported using AFTA

	Total	Transport	Processed Food	Electronics
Positive Impacts				
✓ Market access	22	11	3	8
✓ Preferential tariffs	18	10	3	5
✓ Concentration of production	11	5	1	5
✓ New business opportunities	10	4	1	5
Negative Impacts				
× Increased competition	11	7	1	3
× Relocation of Production	8	5	1	2
× Documentation costs	7	3	1	3
× Competitive Disadvantage with other FTAs	6	3	2	1

Note: Multiple answers allowed.

Source: Authors' computation based on survey data.

Firms Responding to FTAs

- **Sectoral patterns (50% of transport firms have adapted or will adapt business plans)**
- **Food firms and SMEs, even with lower use, have responded by changing business plans.**

% responding firms by category

		Sector			Ownership		Size		
	All firms	Transport	Food	Electronics	Domestic	Foreign	Small	Large	Giant
Firms that use	45.2	50.0	37.5	44.4	23.1	61.1	40.0	47.4	50.0
Firms that use/ plan to use	50.8	60.0	40.0	48.5	31.6	59.1	52.4	52.8	33.3

Source: Authors' computation based on survey data.

Q2. What Impedes Use?

Number of firms (% of responding firms)

Impediments	Non-Users (A)	FTA Users (B)	Total (A)+(B)
Lack of information	86 (78.9)	8 (32.0)	94 (70.1)
Delays and admin costs*	34 (31.2)	7 (28.0)	41 (30.6)
Use of EPZ schemes/ITA	31 (28.4)	5 (20.0)	36 (26.9)
Arbitrary classification/Rent-seeking	20 (18.3)	11 (44.0)	31 (23.1)
Too many exclusions	14 (12.8)	6 (24.0)	20 (14.9)
Confidentiality of information required*	11 (10.1)	6 (24.0)	17 (12.7)
Small margins of preference	9 (8.3)	9 (36.0)	18 (13.4)
Non-tariff measures in partner countries	6 (5.5)	6 (24.0)	12 (9.0)
Number of respondents	**109**	**25**	**134**

Note: Multiple answers allowed. *ROO-related issue.

Source: Authors' computation based on survey data.

Rules of Origin

- Limited burden on firms (27.7% reported ROOs add to business cost)
- Firms are more concerned with delays and admin costs
  - ✓ Authority to issue remains with Customs (self/3rd party ROO certification not available)
  - ✓ Lack of information (step-by-step, tariff data)
  - ✓ Manual processing and people-driven
  - ✓ Lack of tariff codes harmonization
- 43.9% view ROO harmonization as beneficial

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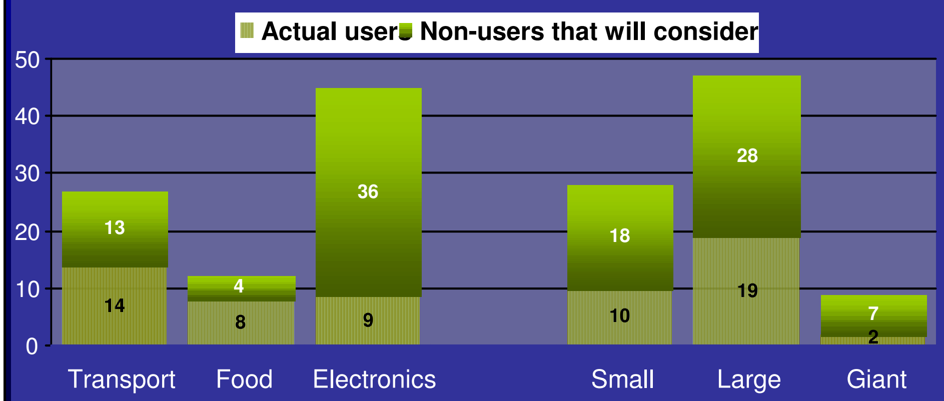
Improved ROO System* Encourages Use

Number of firms, by sector and size



Note: * Reduced value content (30%) and introduction of self-certification.
Source: Authors' computation based on survey data.

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Q3. Enough FTA Support?

	Information-Based Services				Technology-Based Services		Financial/Other Incentives	
TYPE of SERVICE	Awareness training	Impact studies	Enhanced consultations	NTB surveillance	Use of EDIs in ROO system	Technical standards and skills	SME extension	Financial support/ other incentives
FTA services demanded by firms (% of all firms)								
	83	65	43	38	54	52	47	42
FTA services currently used or to be used in future by firms (% responses)								
Govt	Trade & Industry (29.6); Foreign Affairs (1.6)	--	Trade & Industry (29.6); Foreign Affairs (1.6)	Agriculture (0.2)	Customs (14.3)	--	Trade & Industry (29.6)	PEZA (15.6)
Business	Philexport (9.5); Chambers (3.4); Bus. Groups (0.5)	Elect Assoc (5.0); Auto Assoc (2.7); Food Assoc (4.3)	Philexport (9.5); Bus. Groups (0.5)	--	--	--	CC (3.4)	--
Other	Lawyers (3.8); consulting (7.5)	--		Lawyers (3.8); consulting (7.5)	--	--	--	--

- Government as primary source of FTA support (63%)
- Almost 90% demanded information-based services
- Supply gaps in technology-based services; SME support needed

IV. Conclusion and Policy Suggestions

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Conclusion

- FTA as trade policy tool; shift of trade from traditional markets to FTA partners
- AFTA use higher than expected, transport sector with highest usage
- Firms perceive net benefits in FTAs
- ROO system improvement may double FTA use
- Several impediments to use persist, lack of information as main concern
- Supply gaps in technology-based services

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Policy Suggestions

- **Adopt a more pro-active FTA strategy**
  - ✓ Policy statement on FTAs?
  - ✓ FTAs embedded in national programs of economic reforms
  - ✓ Improve administrative mechanism for trade negotiations backed by research
- **Encourage enterprise use of FTAs**
  - ✓ Encourage business associations to play key role
  - ✓ Expand information dissemination
  - ✓ Broad-based consultations (before and during FTA negotiations)
  - ✓ A simpler ROOs regime
  - ✓ SME-focused FTA outreach

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Policy Suggestions (contd)

- **Implement supporting mechanisms for competitiveness**
  - ✓ Technology-transfer and skills upgrading
  - ✓ Backward linkages to sustain investments promoted by FTAs
  - ✓ Support for NTM surveillance, trade finance, and the use of technology (e.g., EDIs) in trade transactions
  - ✓ Explore possibility of adopting cooperation arrangements (e.g., similar to AICO scheme)

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